

Consultation Response

Consultation on Medium Term Changes to the Price Cap Methodology

Office of Gas and Electricity Markets (Ofgem)

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About this consultation

Ofgem is considering changes to the composition and delivery of the Energy Price Cap ('the cap'). These changes are in response to increased wholesale energy prices and greater market volatility. Proposals include quarterly cap changes and reducing from two months to one month the advance notice Ofgem gives to suppliers of the updated cap level. A new mechanism for addressing backwardation cost risk has also been proposed.

Key points and recommendations

- Age UK supports the introduction of triannual price cap changes as a suitable alternative to quarterly cap changes.
- The triannual cap period should begin in mid-November, with subsequent changes in mid-March and July – avoiding any adjustments over the winter months.
- Quarterly changes would entail an inevitable winter cap change which would be consistently more expensive than during lower demand periods and cause difficulties for consumers during the coldest weather.
- Faced with cost increases over winter, older people will be more likely to engage in self-rationing behaviour – turning down their heating when they need it most.
- Quarterly cap changes reduce certainty of cost during the winter, making it more difficult for older people to plan and budget through cold periods.
- A full independent review into what role regulatory failure played in catalysing the energy crisis should be commissioned.
- Price cap contracts risk vulnerable consumers having renewal dates during the winter with Ofgem having less direct oversight and control of price protections.
- Ofgem must pledge to both consult on the introduction of a social tariff and to work with the Government to legislate for the price cap's extension beyond 2023.
- Ofgem should also work with the Government to design a price cap or alternative consumer protection for households who rely on heating sources which are not protected by the cap (e.g. liquified petroleum gas, oil and coal fuels).

About Age UK

Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe, and secure at home; and feel valued and able to participate.

Introduction

We welcome the opportunity to respond to this consultation¹. The Energy Price Cap ('the Cap') is designed to ensure default tariff customers pay a fair price while ensuring suppliers can charge the efficient cost level for energy. While Age UK is cognisant of the issues faced by suppliers in the last few months, we are committed to ensuring that the needs of older consumers, particularly those in vulnerable circumstances, are foremost in the minds of policy makers and Ofgem.

Age UK has provided a range of views on the topics raised in this consultation, but our key focus is on ensuring Ofgem is aware of the dangers quarterly price cap changes pose to older consumers. We wish to restate our strong recommendation that Ofgem adopts triannual price cap changes instead of quarterly ones. Alongside existing reforms, such as the temporary cap reopener under exceptional circumstances, and new proposals for reducing the two-month notice window, we believe triannual changes will be sufficient to reduce supplier volume risk and any negative consumer impact. Crucially triannual cap changes mean that price increases can be avoided during the winter months. We advise that triannual changes start in mid-November, so that no further change will be enacted until mid-March. With concerns regarding energy bills rising amongst the older population cost certainty over the winter is essential.

Three-quarters of older people in the UK – 9.4 million people – are worried about the rising cost of living, according to research for Age UK². Over half (54 per cent) of those surveyed said they'll have to heat their home less³, and a quarter (24 per cent) said they'll have to choose between heating their home and the food they buy, if their energy bills increase substantially. In total, two-fifths (43 per cent) said they would have to cut back, go into debt or simply will not be able to afford to pay their bill⁴.

A combination of suppliers failing, prices rising, and colder temperatures has led to extreme trepidation amongst older consumers. Our own qualitative research late last year showed that older people were worried they would be forced to cut their energy use to levels well below their needs⁵.

Age UK also saw a marked increase in energy related calls to our national Advice Line this winter from older people fearful that they would be unable to keep their heating on. As it stands, we can confidently tell them that if they remain on their default tariff then their per unit energy prices will not further increase over the winter. This is a major source of reassurance and comfort for a fuel poor older person struggling on a low fixed income.

Quarterly cap changes jeopardise the certainty that advice organisations and the energy sector can currently provide. Higher bills over the winter months will almost certainly have a drastic negative impact on consumer confidence. A quarterly cap increase will invariably lead to price changes during the winter and result in older people self-rationing and even self-disconnecting their energy supply when they need it most. This must be avoided as a matter of necessity.

It is also important that Ofgem further consider the needs of people who are not protected by the cap but are still facing rising prices. While natural gas is protected by Ofgem's price

cap alternative heating sources are not covered. This leaves households who lack a gas network connection more vulnerable to price spikes. Many liquid fuels, such as liquified petroleum gas (LPG) and heating oil, and solid fuels, including coal and smokeless fuel, have seen price increases over recent months. In the final quarter of 2021 liquid fuel prices jumped around 24% while solid fuel increased by around 3%⁶. These figures are for a single quarter, and we expect these fuels to continue to grow in price.

Half a million fuel poor households do not have access to a gas network connection⁷. They endure a higher fuel poverty rate – 43% more – than those living in on-grid homes⁸ and their average fuel poverty gap is three times greater than those with a gas connection⁹. As part of Ofgem's price cap review it should agree to work with the Government to design a price cap or alternative consumer protection for households who rely on solid fuel, oil and LPG heating sources.

Ofgem must also reinforce its commitment to consumers by pledging to consult on the introduction of a social tariff. The regulator must also work with the Government to legislate for the Energy Price Cap's extension beyond 2023.

Consultation questions

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

Ofgem must reform its regulatory framework to minimise consumer and supplier risk. Inadequate regulatory oversight played a major role in catalysing the 2021/22 energy crisis. Unexpected increases in wholesale energy prices were exacerbated by ineffective regulation, inadequate enforcement, and inappropriate standards for market entry. The present regulatory framework has failed older consumers and must be reformed. This should include a full independent review into what role regulatory failure played in catalysing the 2021/22 energy crisis.

We are aware that Ofgem already has extensive powers to sanction suppliers¹⁰ and revoke supply licences¹¹. But research from Citizens Advice indicated that Ofgem rarely pursues meaningful enforcement of its rules, instead opting to go after suppliers for technical failures with less direct relevance to consumers¹². Proactive enforcement of existing rules, an improved regulatory framework, better data sharing, and higher standards to market entry would help to avert future supplier failures. Ofgem must bring forward these reforms swiftly if it is to minimise future consumer risk.

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?

Our continued concern regarding the consumer impact of quarterly price cap changes is that this modification exposes consumers to price increases during colder periods from November to March. Quarterly changes risk fuel poor older people self-rationing and self-disconnecting their energy supply when they need it most. Government estimates suggest

around 1 million older households were already in fuel poverty before the Covid-19 pandemic¹³ but now that number is likely to be far higher.

In December 2021 Age UK published the Cost of Cold report¹⁴. The report shone a light on the fear many older people feel as energy prices rise during colder periods. The preeminent concern older people cited was dread at the prospect of having to self-ration their energy use over the winter months¹⁵. Quarterly price cap changes risk compounding dangerous self-rationing behaviour which risks the health and wellbeing of older people struggling on a low income. The impact of price cap changes will also negatively affect the confidence of those living just above the threshold for means-tested support, as well as those on more moderate incomes who are still extremely anxious about rising bills.

Ofgem's own analysis shows that energy bills are generally higher during colder periods¹⁶. This is largely because demand for energy increases as temperatures drop¹⁷. Our view is that a winter price cap change would be consistently more expensive than during other periods. This is problematic because the need for heating, hot water, and energy is greatest during the colder months.

Consumer confidence and certainty of cost are also essential. Present cap arrangements mean that the majority of customers know from October 1st what price they will pay per unit of electricity and gas over the winter and into the spring – well in advance of the coldest periods. This allows fuel poor households to budget for their costs accurately and avoids the terrifying prospect of a sudden bill increase during colder periods.

Quarterly price cap updates mean that cap changes during the winter months would be inevitable. We strongly disagree with quarterly changes and any other modification which could result in prices being able to increase during the coldest periods¹⁸.

During verbal consultation we proposed a compromise solution of cap changes three times a year (triannual changes), in mid-November, March and July. We strongly recommend that Ofgem pursue this option and reinforce the need for any price cap reform to avoid passing additional cost onto consumers during colder periods. We provide greater detail on how we believe triannual changes could work in response to question 12.

Price cap contracts consist of a 6- or 12-month contract period where consumers are committed to the default tariff of their supplier. Age UK welcomes Ofgem's commitment to rule out exit fees on these tariffs if they are enacted. However, it is not clear if Ofgem will have oversight of when a consumer's default tariff will come up for renewal. This proposal could result in consumers who renew during the colder months being hit with a more expensive tariff when their heating needs are at their highest. We provide further evidence of the consumer impact of variable renewal dates in response to question 5.

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?

Price cap contracts risk vulnerable consumers having renewal dates during the winter with Ofgem having less direct oversight and control of price protections. This undermines market fairness when compared with the present composition of the price cap for a variety of reasons.

Higher energy bills are more likely during the winter as demand and prices often increase during the colder months¹⁹. Ofgem's own analysis suggests that if price cap contracts had been in place in 2021 customers renewing in December could have paid in excess of 60% more than the year's average²⁰. This means last year an older market disengaged consumer could have been hit with a 60% higher default tariff because their renewal date was in December. In comparison, a market engaged consumer could have ensured their tariff renewal date fell earlier in the year when prices are generally lower.

Given our strong objection to any price increases being passed onto consumers during colder periods, the uncertainty this new proposal brings is unacceptable and could compound existing inequalities between market engaged and disengaged consumers. The Government recognise that the price cap is particularly important for those consumers who are disengaged from the market and are unlikely to switch from a longstanding default tariff²¹ with Ofgem citing fixing the loyalty penalty as the major motivation for instigating the cap²².

Ofgem must also consider the circumstances of vulnerable customers who may not be as easily able to change supplier or tariff during any switching window and therefore may face higher prices. Those who do not use the internet are more likely to be disengaged from the energy market²³ and older people are more likely to be digitally excluded²⁴. The potential for variable renewal dates on price cap contracts risks compounding the barriers older people face in accessing the best deal. The proposal could have a particularly negative impact on older consumers who have higher heating costs²⁵ and have a greater propensity to live with health conditions which require more heating or energy use²⁶. These factors can make higher energy prices over colder periods particularly dangerous for older people.

If Ofgem did decide to press ahead with price cap contracts, then it should ensure that vulnerable, fuel poor and market-disengaged consumers renew their default tariff during the lowest cost periods. For example, the tariffs of market disengaged consumers could be renewed in-line with the present routine six-monthly price cap changes in April and October, to avoid the risk of expensive renewals during the colder months. Ofgem would also need to mandate suppliers to provide prompts regarding the switching window and inform consumers if there are cheaper tariff options available with other suppliers. However, the administrative burden of this makes it a less than ideal option for the industry to adopt.

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

Our key concern regarding the impact of Ofgem's proposals on consumer engagement is that it will have a differential impact on older people. Levels of market engagement vary year on year for different groups of consumers. At most, two thirds of customers switch or compare energy deals over a given 12-month period²⁷, but the true figure is likely to be much lower²⁸. Market disengaged customers often remain on standard variable tariffs for many years and are now facing even higher bills. They are more likely to be in vulnerable circumstances²⁹ and often face higher barriers to switching supplier.

Consumer surveys show that those who do not use the internet are more likely to be disengaged from the energy market³⁰ with more than half (53%) of those who are not online never having engaged in tariff or supplier switching³¹. Age UK is particularly concerned about the impact of this on older consumers as they are more likely to be digitally excluded³². This is particularly true of the oldest age groups, with around two in five (42%) of those aged 75+ not using the internet³³.

With the competitive switching market collapsed for the foreseeable future restoring consumer confidence with the switching framework will be a real challenge for Ofgem over the coming years. This lack of confidence will be spurred by recent bill increases faced by the customers of failed suppliers. Since the energy crisis began in 2021, customers switched from failed suppliers through the Supplier of Last Resort (SoLR) process saw their bills increase by an average of £30 a month³⁴. For older people who switched to keep on top of their bills, finding themselves with a failing supplier facing an extra £30 monthly charge, their confidence to engage with the energy market will have taken a substantial knock.

A major concern regarding engagement is around the variable renewal dates of price cap contracts. We outlined our full concerns with the potential for variable renewal dates in response to question 5. But with vulnerable³⁵ and digitally excluded³⁶ consumers being less likely to be market engaged these customers may be particularly susceptible to the risk of being hit with higher renewal premiums over the winter months. This is compounded by the additional complexity price cap contracts bring, an issue Ofgem itself recognises as an area of concern³⁷. We are not convinced that price cap contracts will result in consumers habitually engaging in contract renewals as Ofgem suggests³⁸. To address the issue of variable renewal dates the regulator would need to ensure that market-disengaged consumers renew their default tariff during the lowest cost periods (see our response to question 5 for further details).

Question 7: What other operational impacts could a quarterly update or price cap contract have? Please provide data on the costs and benefits

Ofgem needs to further consider the practical impact on consumers of changing the fundamental design and delivery mechanism of the price cap. Quarterly cap changes or

price cap contracts represent a significant departure from the present certainty and clarity provided by biannual cap changes.

We reinforce our previous comments³⁹ that if Ofgem make any changes to the composition of the price cap and how regularly it is adjusted then the regulator will need to promote these changes to consumers via a range of online and offline sources. This must include print media, mail drops, and through community and voluntary organisations. This will help ensure consumers are aware of changes and can adapt to them. With older people more likely to be digitally excluded⁴⁰ Ofgem's promotion of alterations to the price cap must include an offline delivery component.

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

Ofgem has proposed an alternative to quarterly price cap changes – triannual changes. This would mean changes three times a year instead of four times and would mean the inevitable winter price cap changes inherent within a quarterly cap period could be avoided. We welcome Ofgem's inclusion of this option within this consultation and strongly recommend that Ofgem pursue it as an alternative to quarterly cap changes. This option should be followed on the basis that it would avoid inevitable winter price cap changes. These could increase the risk of consumers self-rationing their energy use during colder periods. We outlined our evidence for this from our Cost of Cold report and the Government's fuel poverty numbers in response to question 4.

Ofgem's own analysis shows that energy bills are generally higher during colder periods as temperatures drop and demand increases⁴¹. Our view is that the alternative option of quarterly price cap changes would mean winter price cap alterations would be inevitable. Because demand is higher these changes would be consistently more expensive than during other periods. This is problematic because the need for energy is greatest during the colder months as additional heating is required to keep households warm and avoid the negative health and wellbeing impacts of living in a cold home.

When compared with the present biannual cap changes, triannual changes provide less certainty to consumers but would still ensure they know what price they will pay per unit of electricity and gas over the winter in advance of the coldest periods. This allows fuel poor households to budget for their costs accurately and avoids the terrifying prospect of a sudden bill increase during the winter.

With this in mind, we recommend that the triannual cap is pursued as the preferred reform option and that the window be set from mid-November to mid-March, with a further change in mid-July. This would avoid any price increases during the coldest periods.

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?

Ofgem presently give suppliers almost two months notice of a price cap change. The regulator is proposing a reduction to just 28 days. The argument for reducing it is that it decreases the likelihood that prices diverge between the notice point and cap implementation date. Because suppliers often buy their energy well in advance of delivering it to customers this proposal would also reduce the average gap between their purchase and delivery points – shortening it from 5 months to 4⁴². Ofgem argues that this should reduce the variance between forward contract and delivery prices.

Consumers should benefit because the cap will better reflect actual prices. But the change would mean a slight increase in the scale of price changes between cap periods and could foster greater market volatility as contract delivery dates approach faster.

Last year's supplier failures cost consumers considerably. Resultant higher costs will be felt by consumers from April⁴³ and customers switched from failed suppliers already faced an average bill increase of £30 a month⁴⁴. A reduced notice period which ensures the cap better reflects prices at the time of delivery may reduce the risk of supplier failures and avert similar negative consumer consequences.

There are however important operational considerations to account for. A 28-day notice period would mean consumers having less notice of a cap change. This could make it more difficult for them to plan for a potential increase in prices (reinforcing the need for comprehensive promotion of any cap modifications, see response to question 7). As Ofgem highlights, this policy would also increase the scale of price changes between cap periods and could foster greater market volatility.

However, based on Ofgem's assessment and the balance of risks it is our view that reducing the notice window to 28 days would be generally beneficial to consumers as it improves the durability of the price cap and ensures it better reflects supplier costs. However, our support for this proposal is subject to Ofgem agreeing to enact triannual cap changes instead of quarterly cap changes. Quarterly cap changes would mean a change would be made over the winter months. If the change was placed in January, for example, then this combined with a 28-day notice period could result in consumers being informed of a cap change in December – facing potentially higher prices from January. This could undermine consumer confidence, increase customer anxiety and lead to dangerous self-rationing behaviour during a period where older people need the confidence to leave their heating on.

Furthermore, as we have recommended previously⁴⁵ enacting multiple complex changes to the price cap in response to the energy crisis will unfairly shift market volatility risks away from suppliers and onto consumers. It is our view that triannual cap changes, which avoid passing on additional cost during the winter months, combined with a 28-day notice period would be a more proportionate response to mitigating supplier risk. The same policy enacted with quarterly changes would present a serious threat to older consumers given

that quarterly changes represent a greater risk to their wellbeing over the winter months (see response to question 4).

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² Online survey conducted by Opinium on behalf of Age UK between 14th and 18th January 2022. Sample of 1,280 UK residents (65++), weighted to be nationally representative of the 65+ age group.

³ For example, by turning down the heating, keeping it switched on for fewer hours, or heating only part of their home.

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¹² Citizens Advice, 2021. Market Meltdown: How Regulatory Failures Landed us with a Multi-billion Pound Bill. Citizens Advice. [Online]. Available at: <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Market%20Meltdown%20-%20Citizens%20Advice%20Dec%202021.pdf>. Pgs 14-22.

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