

National Energy Action (NEA) response to Ofgem Consultation 'Price cap - Statutory consultation on changes to the wholesale methodology'



Action for Warm Homes

About National Energy Action (NEA)

NEA¹ works across England, Wales and Northern Ireland to ensure that everyone in the UK² can afford to live in a warm, dry home. To achieve this, we aim to improve access to energy and debt advice, provide training, support energy efficiency policies, local projects and co-ordinate other related services which can help change lives.

Our Response

Over the last year, energy prices have increased significantly, with the default tariff price cap being set at £1042 for the winter period of 2020/21, and now being set at £1971, almost doubling in the space of just 18 months. Ofgem's Chief Executive recently told the BEIS committee that he expects the price cap to rise again in October, reaching £2800³/year for the average direct debit customer. That is an increase in approximately 170%.

Since that intervention, the UK Government announced a series of measures⁴ in an attempt to mitigate the energy crisis for household who are the most vulnerable to the impacts of fuel poverty. This will largely mitigate the impact of the expected October price increase, but with energy prices already extraordinarily high, NEA still expects millions of households to struggle to keep warm this winter.

At the same time, Ofgem has looked to alter the methodology behind the price cap in order to reflect the greater levels of risk that energy suppliers face as a result of significant volatility in wholesale electricity and gas markets. While NEA is pleased that Ofgem has listened to some of our concerns, and limited quarterly changes to wholesale prices only, we are concerned that for the most part, the proposed changes will create additional costs in the price cap in the short term, exacerbating affordability issues this winter, regardless of their impact on bills in the longer term (through reducing supplier failures).

In particular, NEA has been concerned about the proposal to move away from altering the price cap two times per year, towards a quarterly cap. We have consistently argued that such a change does not give SVT customers confidence in their energy prices over a prolonged period (especially during winter) and could result in many smaller changes to the price cap which could be confusing for households and erode consumer confidence. We were perhaps most concerned that Ofgem would need to increase the level of the price cap in the middle of winter, just after Christmas. This is the worst time for families to face increasing costs.

Unfortunately, this concern seems likely to become a reality if Ofgem take the proposal for a quarterly cap forward into supplier licences. Cornwall Insight have recently predicted that a quarterly price cap would indeed mean a likely increase in cap level in January – which they currently estimate to be a £40 increase. This would be an unacceptable outcome that is entirely avoidable. NEA notes that the impact assessment for a quarterly cap has modelled falling costs over the period, with the benefit of lower costs being passed through quicker. With current information, a quarterly cap only allows higher prices to pass through to households more quickly.

Our clear preference throughout the policy development process has been for the 'Enhanced Status Quo' option, and this remains unchanged. We have also said that if Ofgem must move to the quarterly update option, there must be two changes:

- If the updates were set up so that the price cap did not change over the winter period. This is a crucial period for fuel poor households as they require confidence to use their heating to maintain a healthy temperature. Updating the cap in March, November, May and August, for example, would achieve this.
- Predictable costs, such as policy and network costs, should only change once per year, limiting the sharpness of changes with each additional update.

In light of these changes not reaching fruition, NEA urges Ofgem to delay the implementation of a quarterly price cap until after this winter, in order to avoid a devastating price increase at the beginning of January, typically the most difficult month for low-income families to make ends meet. If this cannot be achieved, and Ofgem does have to increase the price cap this winter, an avoidable situation will compound an already miserable situation for fuel poor households this winter.

NEA has two additional proposals, that we hope Ofgem will consider

1. To provide a separate level of price protection for a set of vulnerable energy consumers. It is becoming clear that while the reforms to the price cap may work for the population in general, a move to quarterly pricing, a reduced notice period and more wholesale allowances will lead to adverse outcomes for the most vulnerable households. Creating a separate price cap (much like the previous safeguard tariff) could reduce these issues, providing additional protection for the most vulnerable households. This could be done, for example, through altering the prepayment price cap methodology to reduce the differential to the Direct Debit tariff cap level, while maintaining a 6 monthly cap update and a longer notice period
2. To reduce the level of standing charges, particularly for prepayment customers, through changing the recovery of the Supplier of Last Resort Levy to being volumetric.

¹ For more information visit: www.nea.org.uk.

² NEA also work alongside our sister charity Energy Action Scotland (EAS) to ensure we collectively have a UK wider reach.

³Ofgem evidence to the BEIS Committee, 24th May 2022 <https://committees.parliament.uk/oralevidence/10331/pdf/>

⁴ Cost of Living Measures Factsheet, HMT, 2022 <https://www.gov.uk/government/publications/cost-of-living-support/cost-of-living-support-factsheet-26-may-2022>