



Response to Ofgem's discussion paper on the price cap

9th May 2024

About Fair By Design

Fair By Design is dedicated to reshaping essential services such as energy, credit, insurance and payments so that they don't cost more if you're poor – also known as the poverty premium. Fair By Design collaborates with regulators, government and industry to design out the poverty premium. Our Venture Fund provides capital/funding to grow new scalable ventures to innovate the market and design out the poverty premium. Ascension manages the Fair By Design Fund. Fair By Design is managed by the Barrow Cadbury Trust on behalf of a group of foundations.

In the context of the energy market, we believe that households on low incomes/living in poverty should not incur a poverty premium based on not being an "active" consumer or due to the way they pay for their energy.

Please note that we consent to public disclosure of this response.

For more information about this response please contact Maria Booker:

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Response from Fair By Design

Due to lack of capacity Fair By Design is unable to give a full response to this discussion paper. However, our views about the continuing need for consumer protection in the energy market are set out in our response to DESNZ's call for input on default tariffs (attached below) and our response to Ofgem's call for input on affordability and debt.

Whilst we recognise the valid reasons for reforming the price cap, we would like to emphasise our ongoing support for price protection for those on low incomes (in addition to support with bills). As the discussion paper sets out, the price cap has been successful at tackling the loyalty penalty. When the Personal Finance Research Centre, University of Bristol produced their groundbreaking report "Paying to be Poor: uncovering the scale and nature of the poverty

premium”¹ the team found that nearly half of the average poverty premium faced by low-income households (£233) came from not being on the best fuel tariff, therefore we are keen to ensure that the loyalty penalty does not return. We are equally keen to ensure that those who are not able to flex their energy usage are protected from unfair prices in future.

We also agree with National Energy Action that the price cap has introduced welcome transparency about the drivers of any increase in energy, and that consumers welcome this protection being in place, and that consideration needs to be given as to how these benefits can be retained.

We look forward to seeing Ofgem’s thinking on reform of the price cap following this discussion paper.

¹ University of Bristol, (2016). *Paying to be Poor: Uncovering the scale and nature of the poverty premium* [pdf] Fair By Design. Available at: <https://fairbydesign.com/wp-content/uploads/2019/08/University-of-Bristol-Paying-to-be-poor.pdf>

Response to DESNZ's call for evidence on default tariffs

22nd April 2024

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Background

Default tariffs are the deals that consumers start on or return to when they have not proactively chosen a tariff or their current deal has come to an end. Due to the unprecedented situation in the energy market over the last couple of years, around 86% of households are currently on default tariffs. This proportion is expected to fall but many households will continue to rely on default tariffs for the foreseeable future.

At present default tariffs do not reflect the fact that the cost of energy differs depending on the time of day. At the moment, the way the system settles how much energy is used and paid for is too crude to reward consumers for using energy more efficiently. However, in 2025 we will start the transition to Market-wide Half Hourly settlement (MHHS) which will encourage suppliers to reward households for shifting their energy usage to cheaper times of day. There are no plans to get rid of default tariffs but DESNZ is considering how default tariffs should change as a result of MHHS. At the same time Ofgem is considering whether the price cap should be reformed.

Summary

- Fair by Design would like to see a 4th principle, “Default tariffs should not create poverty premiums”, added to the three proposed principles. We agree that the market has an important role to play, but this needs to be balanced with meeting the needs of those who cannot engage in the market who should not be penalised. We think that this should be an easy principle for the Government to accept – no system should be designed to penalise those on low incomes. However, if the Government is unable to accept this principle we would like DESNZ to spell out why in its response.
- Consumers on low incomes are not a homogenous group. We need to recognise that some low-income consumers cannot shop around and/or flex their energy usage. However, some households on low incomes will welcome this opportunity if it is accessible. Fair By Design calls on both DESNZ and Ofgem to engage with people on low incomes to co-create default tariffs (and price cap arrangements) that meet their needs.
- The smart meter roll out is a crucial enabler of this transition. Incentives need to be put in place for suppliers to mend broken smart meters to ensure those who want to use energy more flexibly can do so. Furthermore, the smart meter roll out framework should be extended beyond 2025.
- We need a discounted energy tariff in place to ensure that there is a safety net for those least able to pay their energy bills. Knowing that a mechanism is in place to protect those who need it would open up the conversation on default tariffs, and other important issues concerning the future of the energy market. We urge the Government to consult on energy bill support, as promised, as soon as possible.

Questions

Q1) Do you agree with these principles?

Q2) Are there any other key decisions concerning the future regulation of default tariffs that you believe these principles would not cover?

Q1 & 2

We would like to see a 4th principle added to the current three. Principle 4 should be: “Default tariffs should not create poverty premiums”. When the Personal Finance Research Centre, University of Bristol produced their groundbreaking report “Paying to be Poor: uncovering the

scale and nature of the poverty premium”² the team found that nearly half of the average poverty premium faced by low-income households (£233) came from not being on the best fuel tariff, and that three-quarters (73 per cent) of low-income households the team surveyed had not switched fuel supplier in the last two years. This was higher still among the digitally excluded (83 per cent). We are keen to prevent the return of this poverty premium or the development of a new poverty premium for not being able to flex the way you use energy. (It is worth noting that if you live in a household with someone with a disability you are more likely to be living in poverty.)

We welcome the recognition that whilst some consumers will want to play an active role in choosing their energy supplier and tariff, others will not be able to actively engage in the energy market, for a variety of reasons. These people still deserve access to an essential good at a fair price.

We agree with principle 2 (default tariffs should protect consumers from unnecessary complexity and costs). We think this principle should incorporate the assumption that anyone who ends up on a default tariff could be vulnerable and therefore the tariff should be simple, fair, and unlikely to cause harm.

We also agree with principle 3 (households should not be exposed to excessive costs from the inefficient use of high-consuming items by other consumers).

Our main reservations are around principle 1 (the market should be free to reward households for using energy smarter) particularly in light of the Government’s disappointing decision to go back on its promise to consult on energy bill support. Adequate bill support would provide an important safety net to underpin these changes, which would mean consumer organisations would be open to more radical changes. Fair By Design recognises the importance of using the electricity grid efficiently and that price is an important tool in incentivising that. But the market, especially for an essential service like energy, must serve the values of society. This means harnessing the market to facilitate our move to a net zero economy but not letting it run “free”. The Government and Ofgem have an important role to play in constraining the market to ensure that the transition is fair. Rewards must be proportionate and accessible to all who want to engage in behaviour that helps manage demand on the grid. But those who cannot engage should not be penalised.

The consultation paper suggests we may see the introduction of energy tariffs that “could help with the upfront costs of bringing low-carbon technologies into households”. However, past

² University of Bristol, (2016). *Paying to be Poor: Uncovering the scale and nature of the poverty premium* [pdf] Fair By Design. Available at: <https://fairbydesign.com/wp-content/uploads/2019/08/University-of-Bristol-Paying-to-be-poor.pdf>

experience suggests the market rarely targets those on low incomes. Whilst we have seen innovative tariffs develop for electric vehicles (EVs), the same cannot be said for storage heaters which make a significant contribution to flexibility. In fact many people on Economy 7 (9% of households) have had a very poor experience as Sustainability First has highlighted³. Rather than relying solely on the market to make smart technologies affordable, the Government needs to ensure stable public funding is available to help households with the upfront costs of the energy transition, as recommended by the National Infrastructure Commission⁴.

Ensuring no new poverty premiums are created means using inclusive design techniques to ensure that default tariffs are designed to meet the needs of those on low incomes (for a case study please see Fair By Design/Ofgem/Toynbee Hall's Participatory Action Research on the transition to net zero⁵). Energy suppliers should also work with those on low incomes to develop products that meet their needs. Further research and engagement is needed to assess how many people on low incomes and with disabilities can't engage in the market, and how many would engage if the circumstances were right. The Centre for Sustainable Energy (CSE)'s evaluation of the demand flexibility service in 2022/23 for the Electricity System Operator (ESO)⁶ showed that socio-economic groups D and E were over-represented in the group that participated (even though overall those on low incomes were underrepresented) suggesting that there is appetite amongst some low-income consumers to be more flexible in the way they use energy in order to save money. If we saw low-income consumers spread more evenly between default tariffs and other tariffs it would indicate that the market was working more effectively for all consumers. We want to see the Government and Ofgem regularly assessing whether those on default tariffs are paying more for their energy than those on other tariffs, and if those on default tariffs are disproportionately on low incomes to assess whether a poverty premium exists. If a poverty premium does exist, action must be taken to eliminate it.

The evolution of default tariffs

³ Frerk, M. (2023). *How regulation is failing three million households* [blog] 6th February 2024. Available at: <https://www.sustainabilityfirst.org.uk/blog/443-economy-7-blog-frerk>

⁴ National Infrastructure Commission, (2024). *Second National infrastructure Assessment*. Available at: <https://nic.org.uk/studies-reports/national-infrastructure-assessment/second-nia/#tab-netzero>

⁵ Fair By Design, Ofgem, Toynbee Hall (2023). *A case study: using inclusive design to create a fair transition to net zero*. Available at: <https://fairbydesign.com/wp-content/uploads/2023/05/FBD-Ofgem-Toynbee-Hall-Inclusive-Design-in-Action-FINAL-April-2023-2.pdf>

⁶ Centre for Sustainable Energy, (2023). *Household Engagement with the Demand Flexibility Service 2022/23*. Available at: <https://www.nationalgrideso.com/document/282981/download>

3. With current licence conditions, do you believe most domestic consumers will continue to default onto single-rate standard variable tariffs in future or are suppliers likely to consider using Time of Use tariffs as a default?

4. Should protections be placed on the type of default tariffs that suppliers use for domestic consumers? If so, what should those protections be; for example, is there a case for limiting default Time of Use tariffs to static rather than dynamic pricing?

Yes, there is a case for limiting default Time of Use tariffs to static tariffs. We would like to see Ofgem/DESNZ doing its own inclusive design work with those with lived experience of being on a low income to develop default tariffs (and also price caps) that would work well for low-income consumers. However, feedback from the focus groups we have run with Poverty Alliance with people on a low income suggests that many already find the energy market over-complicated and overwhelming. We think that static time of use default tariffs could work as long as the peak and off-peak time bands were relatively straightforward and stable over time. Additional protection for low-income consumers with medical conditions/disabilities who are unable to shift their consumption of energy, would also be required. However, we predict that a dynamic default tariff, that changes on a daily basis, could create a high degree of stress, anxiety and indeed financial detriment for some households who find themselves on this type of tariff unexpectedly and therefore this is an appropriate choice for a default tariff.

5. Should there be different default arrangements for consumers identified as being vulnerable?

Ofgem's definition of vulnerability⁷ recognises that vulnerability can be complex and multi-dimensional and it relates to the circumstances that individuals find themselves in, and how they combine with aspects of the market. Vulnerability can be transient rather than permanent. It would therefore be difficult to draw a hard dividing line between consumers who are vulnerable and those who are not.

We think a better approach would be to design default tariffs on the assumption that anyone who ends up on a default tariff could be vulnerable. If the principles set out above are followed ie default tariffs are simple, they do not impose unfair costs caused by the inefficient energy use of others, and they do not create poverty premiums, they should be suitable for those that are vulnerable.

⁷ Ofgem, (2019). *Consumer Vulnerability Strategy*. Available at:

https://www.ofgem.gov.uk/sites/default/files/docs/2020/01/consumer_vulnerability_strategy_2025.pdf

We have considered whether pre-payment meter users who are disproportionately on low incomes compared to other users, should be treated separately. However, suppliers have an obligation to ensure pre-payment meter users are not vulnerable and that a pre-payment meter is appropriate before installing one, and continuing to check that remains the case. As long as Ofgem monitors suppliers' performance on this effectively, we see no need for this group to be treated differently.

A more effective way of helping vulnerable customers would be to have a default social tariff with auto-enrolment for those in receipt of benefits and/or on a low income.

6. What rights should domestic consumers have over the type of tariff they default onto? Should all suppliers be able to provide both single- and Time of Use default tariffs for households to move onto?

All consumers, and particularly those on low incomes should have a right to default to a tariff that meets their needs. At present, energy suppliers have to advise customers if there is a cheaper tariff that would benefit them. However, suppliers should also have to tell customers if they would be better off on a different type of tariff.

We believe there is a case for putting those who place the most demand on the grid, ie those with electric vehicles, in a separate category, who should default to a dynamic time of use tariff. Given the price of electric vehicles, it is safe to assume that EV owners are not generally on a low income at present. It is also highly likely that EV owners will be used to the idea of charging their car at an off-peak time and therefore a dynamic time of use tariff is unlikely to catch them out. However, treating this group separately will also make it less likely that householders without access to EVs will have to bear the burden of their inefficient use.

On the other hand, “non-smart” households should be provided with a default tariff that meets their needs ie a single tariff or a static time of use tariff that is highly predictable. We urge the Government to engage with consumers, particularly low-income consumers to assess their preference on this.

7. Are there specific default tariff arrangements that you believe industry or public bodies should trial? Default tariffs for low carbon technologies

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Default tariffs for low-carbon technologies

8. Do you agree that default tariffs for households with electric vehicles should be smart Time and/or Type of Use Tariffs?

- 9. Should there be protections to the type of tariffs that households with electric vehicles default onto? If so, what should those protections be; for example, should they use static rather than dynamic pricing?**
- 10. What should default tariff(s) be for electric vehicle owners who do not possess a smart meter or smart charge point? Do you believe many electric vehicle owners are likely to be in that situation in future?**
- 11. Are there any other technologies, for example storage heating, which you believe should influence the default tariff arrangements of the households?**
- 12. We do not believe that evolutions in default tariff types is likely to have significant impacts on households' ability to use or export power they generate at home with equipment like rooftop solar panels. Do you agree? If not, why?**

Default tariffs when fixed-term tariffs for low-carbon technologies end

- 13. If an electric vehicle owner has chosen a specific tariff, do you believe they could face a detriment if they default onto a different tariff structure at the end of the fixed term?**
- 14. How should (a) suppliers and (b) load controllers protect domestic electric vehicle owners who have previously chosen a specific tariff and charging structure, when the fixed term ends? Should there be a rule or principle encouraging default arrangements to maintain some consistency of tariff type when a fixed term ends? Is there a case for electric vehicle (EV) tariffs to be evergreen or rolling fixed terms?**

Questions 8-14

Fair By Design is concerned with consumers living in poverty who, by and large, do not currently have access to smart technologies, particularly EVs.

However, we do strongly support the principle that households who do not currently have access to these technologies, should not have to bear any costs of these smart technologies being used inefficiently.

We also urge the Government to consider and to consult on what support might be needed to ensure that low-income households can also access smart technologies so that no one is left behind in the transition to a net zero energy system.

We also note that having a functioning smart meter is key to accessing these technologies. The current policy target is to have 75% of households fitted with a smart meter by the end of 2025 with no framework or target beyond that date. This potentially leaves 25% of households without a smart meter.

Furthermore, we urge the Government to revisit the incentives in the smart meter roll out scheme given that DESNZ's own figures⁸ showed that nearly 4m smart meters (8.5%) were not operating in smart mode at the end of last year (2023). Whilst energy suppliers are required to take all reasonable steps to install smart meters, they are not required to ensure that smart meters are working or even commissioned. We have heard directly from people on low incomes who have had smart meters installed to avoid having to manually top up their pre-payment meter key and yet their smart meter has remained inoperable for months. Not only has this deprived the individuals concerned of the benefits they anticipated, it has also created huge anxiety over the size of the final bill that might emerge.

Consideration of the smart meter roll out is missing from both this call for evidence and Ofgem's call for input on future price protection. However, not addressing this issue is likely to result in a two-tier system. Consumers with a broken smart meter, or who cannot have a smart meter fitted in their home, or who haven't been reached by the smart meter roll out, will end up in the higher tier, being charged more, through no fault of their own.

The price level of future default tariffs

15. Should the current default tariff cap be either reformed or replaced with more flexible price regulations as we transition to MHHS? If so, when in the transition to MHHS do you believe that change should take place?

Our primary concern is that we don't lose sight of the reason for introducing the price cap in the first place, ie to remove the unfair premium faced by those who did not actively engage in the market. It is vital that whatever arrangements are put in place, this premium is not permitted to return, and that a new version of this premium related to not flexing energy usage is not allowed to develop.

We are open to the idea of the default tariff cap being revisited given the significance of the change to market-wide half hourly settlement (MHHS). However, it is worth noting that only 51% of the current price cap (Jan 2024- March 2024) is determined by wholesale prices and while that will be affected by MHHS the other 49% is important too. We echo National Energy Action's point that a further benefit of the price cap is the transparency it creates over why prices have gone up or down and the consumer trust it creates, which is in short supply in the energy market at present. There is a benefit to Ofgem retaining some control over making sure fixed costs (for example policy costs) are distributed fairly rather than this being solely left to

⁸ Department for Energy Security and Net Zero (2024). *Smart meters in Great Britain, quarterly update December 2023*. Available at: <https://www.gov.uk/government/statistics/smart-meters-in-great-britain-quarterly-update-december-2023>

suppliers. It is essential that any revised arrangements going forward retain or strengthen the protection the default tariff cap has offered to those who are not willing or able to be “active” energy consumers.

It will be important to fully understand the details of the transition that is being made before determining timing.

16. Do default price regulations need to support a greater diversity of tariff types to help secure lower long-term bills and meet households’ different energy needs? If so, how might this best be achieved?

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The future regulation of default gas tariffs

17. If price protections for default electricity tariffs are reformed in future, do you believe that regulations for default gas tariffs should also be updated?

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