

Dear Ms. Rossington

Please find attached a submission to Ofgem's consultation on its proposals for setting and updating a default tariff cap as set out in your documents of 6 September 2018.

This raises significant concerns with the form of price cap that Ofgem is planning to implement. It also proposes an alternative that will yield much greater savings for consumers, in particular low income households, and significantly reduce carbon emissions, which Ofgem regrettably chose to exclude from its impact assessment.

I outline the fundamental concerns in general terms before highlighting a couple of particular points (labelled as per the relevant consultation documents) where Ofgem's latest proposals are noticeably deficient.

Drawbacks with the price cap proposed by Ofgem are:-

- It offers the greatest savings to those who consume most energy, who are those on the highest incomes. Low income households, who are most in need of help with energy bills, will actually save the smallest amounts.
- It will damage competition as consumers will stop seeking out good deals and suppliers will stop offering them. This is what happened when the pre-payment meter cap was introduced last year. Thus customers who are currently on good deals are liable to see their bills increase.
- The form of price cap that Ofgem is proposing entails uncertainty about the efficient level at which to set it. Ofgem is planning to allow for this by adding £12 p.a. of 'headroom' to the level of the cap, thereby reducing the savings to consumers.
- Ofgem's proposed cap will increase carbon emissions and reduce security of supply. Ofgem has misleadingly downplayed these effects and disregarded its statutory principal duty to reduce emissions and improve security of supply.

The alternative is to cap just the standing charge. The average dual fuel standing charge is £160 p.a., whereas the related costs energy suppliers incur are some £100 lower so the standing charge could be capped at £60 p.a. (see further below).

A cap on the standing charge would have four powerful effects:-

- It would target protection at low income households, who are the most vulnerable consumers – the least able to avoid paying high prices for energy and the most likely to suffer hardship as a result. In particular, they consume the least energy so the standing charge forms a large part of their total bill, which means they pay the highest overall rate for the energy they use.
- Unlike price caps generally, a cap on the standing charge would dramatically boost competition. Consumers would find it much easier to compare tariffs as they would only need to consider the unit rates.
- The few types of cost incurred by suppliers that should be recouped through the standing charge can be estimated much more accurately and transparently than suppliers' other costs so a standing charge cap would minimise the uncertainty and regulatory risk that come with a cap. This means it could be set at the efficient level of costs (without 'headroom'), thereby maximising the savings to consumers.
- While those in fuel poverty would be able to afford more energy, the resulting higher unit rates would lead consumers to reduce energy consumption overall. This would lower

carbon emissions, improve security of supply and reduce the need for investment in additional generation and network capacity (which would otherwise have fed through to customers' bills).

Low income households would directly save £450 million p.a.. But, by combining more effective competition with this targeted protection for those who are unable to benefit from it, it has the potential to eliminate the entire £1.4 billion p.a. consumer detriment.

In spite of this Ofgem did not include the option of a standing charge cap in the impact assessment it carried out before deciding on the form of cap. This is perverse.

Capping the standing charge in energy bills to businesses as well could eliminate the current £220 million p.a. detriment to SMEs in the same way.

The paper also identifies ways for Ofgem and the Government to lowering energy bills further by addressing competition problems in metering markets and eliminating VAT on the standing charge.

A standing charge cap provides a general model for regulation of retail markets for essential services where competition is not effective, such as metered water services.

I was interviewed about these issues on Radio 4's PM programme recently and this interview can be heard here: <http://idealeconomics.com/ideal-economics-radio-4/>

Overview document paragraphs 2.76-2.79 (and Appendix 5)

Ofgem is proposing to set the standing charge in the cap at the current level of the standing charge in SVTs. Ofgem has sought to justify this on the basis that, despite agreeing with us that almost all network and policy costs should not be recovered through the standing charge, it has bizarrely estimated the cost-reflective level of the standing charge at £225 p.a.. This cost estimate is not credible: it suggests that profit-maximising energy suppliers with market power over passive consumers currently price at below cost the part of energy tariffs which consumers have no discretion over paying.

Appendix 11

Having failed in previous consultation on the default tariff cap to do so, Ofgem has finally included an estimate of the extent to which its price cap will increase energy consumption and greenhouse gas emissions. However, it used the lowest figures in the ranges of estimates in the studies of energy price elasticities that it cited (0.35 for electricity and 0.1 for gas). Ofgem offered no justification as to why the lowest figures (which are applicable only in the short run) were the most appropriate.

Using these lower figures, Ofgem found that its proposed price cap would lead to an increase of 0.36% in total UK domestic greenhouse gas emissions (to the extent that the cap does not lead to prices of tariffs not covered by the cap rising to the level of the cap). However, using the corresponding long run or overall elasticity estimates from the studies cited (0.85 for electricity and 0.28 for gas), which may be said to be more appropriate as they capture the entire effect of the price cap, suggests the increase in total UK domestic emissions caused by the cap would be approx. 1%.

Ofgem has not conducted a full environmental impact assessment and said that conducting one would be "disproportionate". However, it is clear that its proposed measure will have a very significant impact on greenhouse gas emissions.

Again, Ofgem does not appear to have considered the effect of the increased energy consumption resulting from the price cap on security of supply. It also has not sought to protect the interests of consumers by reducing greenhouse gas emissions and improving security of supply even though this is one of its statutory principal duties.

Kind regards

David