# Call for Input Response

## Adapting the price cap methodology for resilience in volatile markets

Office of Gas and Electricity Markets (Ofgem)

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## About this consultation

Ofgem is considering options for updating the Energy Price Cap ('the Cap') to better account for the impact of increased wholesale energy price volatility and related supplier volume risks.

## Key points and recommendations

- A comprehensive independent review must be commissioned to explore the causes of the Energy Crisis and what role regulatory failure played in catalysing it.
- If better enforcement of existing rules, improved regulation, and higher standards thresholds for market entry would be sufficient to avert future crises then we question the need for wider Price Cap reforms.
- Ofgem must review all options for reducing the 8-month time lag between forward wholesale prices and their recovery through the Cap using the existing Cap method.
- Ofgem must be mindful of the cumulative impact on consumer safeguards of instigating multiple complex changes to the Cap simultaneously.
- As part of its Price Cap review, Ofgem should commit to consulting on the design and implementation of a social tariff.
- Ofgem should reinforce its commitment to the Cap and work with the Government to legislate for its extension beyond 2023.
- Subject to Ofgem addressing our concerns, our preferred reform option is to allow for alterations to the Cap value outside of the normal period only under prescriptively defined exceptional circumstances.
- We would only support this option subject to our recommendations – primarily that the Price Cap should not rise during the coldest months of November to March.
- Quarterly Price Cap updates pose a threat to consumer confidence over colder months and would not be subject to exceptional circumstance tests.
- Fixed-term default tariffs could result in consumers whose contracts end during the colder months facing more expensive bills when their heating needs are greatest.
- We do not believe default tariff exit fees are compatible with a fair and accessible energy market for low-income households and prepay customers.

## 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 call for input. 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's response to the three questions raised in this consultation reflects our determination to the see the Cap fulfil its primary duty – to prevent consumers from paying unfair prices for an essential service like energy. While minor changes may be needed to improve the responsiveness of the Cap, the cumulative impact of multiple complex changes could undermine consumer protections and unfairly shift market volatility risks away from suppliers and onto consumers.

While on balance we support alterations to the Cap via a re-opener mechanism, subject to our strict reservations below (see response to question 2, option 1 and our previous consultation response[1]), we urge Ofgem to first consider its existing options for mediating market volatility and volume risk. This must include an independent review of the role Ofgem's regulatory framework played in the Energy Crisis and Ofgem committing to assess existing measures it could use to reduce the 8-month time lag between forward wholesale prices and their recovery through the Cap.

Beyond this, Ofgem must work with Government to improve support for consumers to meet the scale of need this winter, throughout 2022 and beyond. Estimates suggest that from April, consumers will be expected to spend an additional £600 on their energy bills to cover the expected Price Cap rise and supplier failure costs[2]. Extra support to subsidise spiralling energy costs is essential to prevent unprecedented health and debt crises. Ofgem must reinforce its commitment to consumers by pledging to both consult on the introduction of a social tariff and to work with the Government to legislate for the Cap's extension beyond 2023.

### Question 1: what is your view on the nature and scale of the volume risk facing suppliers, and the case for changing the current price cap methodology?

Volume risk comprises the twin issues of suppliers having more customers than expected on default tariffs as prices rise and seeing increased numbers of customers leave default tariffs as prices fall[3]. This makes it more difficult for suppliers to appropriately plan for future costs within the confines of the Price Cap, with volume risk exacerbated by energy price volatility and the eight-month delay between forward wholesale prices and their recovery through the Price Cap[4]. If left unmanaged volume risk during a volatile energy price cycle could potentially lead to an increase in supplier failures which will likely have a negative impact on consumers[5].

**In terms of the nature of the Energy Crisis and its impact on volume risk**, Age UK is cognisant of recent issues faced by suppliers. We welcome reform of the Price Cap if it can better account for unexpected costs, avoid additional onerous expense for older households, and ensure sufficient consumer protections remain in place. However, we urge Ofgem to first consider its existing options for mitigating market volatility and volume risk.

Ofgem must be mindful of the role its own inadequate regulatory framework played in facilitating the Energy Crisis. Recent analysis from Citizens Advice[6] outlined a range of Ofgem's mistakes, delays, and inaction across a variety of areas – regulatory failures which helped catalyse the Energy Crisis. While changes to the Price Cap may improve its resilience and reduce volume risk, Ofgem must reflect upon what wider regulatory reform and enforcement work it will need to undertake to avoid future crises. This must include commissioning a comprehensive independent review into what caused the Energy Crisis and what role regulatory failure played. Consumers should not be made to pay the price for the mistakes of a permissive regulatory regime.

**In terms of the scale of recent events,** while the Energy Crisis has increased the risk of insolvency for suppliers, the costs of business failure are ultimately borne by the consumer through their bills. 27 suppliers went bust in 2021 with almost 2.6 million domestic consumers affected[7]. A predicted increase to the Price Cap in April of around £500, combined with an additional £100 to cover supplier failure costs, could result in a £600 increase in the typical energy bill from April[8] - further exacerbating the Crisis later this year.

Ofgem must also consider how the crisis has impacted the competitiveness of the retail energy market. Customers of the 27 failed suppliers have been awarded through the Supplier of Last Resort (SoLR) process to 10 other companies. This does not include the estimated 1.7 million customers of the largest failed supplier Bulb who will need to be transferred from the Government run administrator to other suppliers. Whilst the costs of currently serving these customers is more than the Price Cap allows suppliers to charge, costs faced by SoLRs will ultimately be paid by consumers through their bills. Switching to a new fixed tariff was previously promoted by Ofgem as the best way of consumers protecting themselves against high bills. However, the competitive switching market has collapsed for the foreseeable future. Many customers transferred to SoLRs will become 'sticky' with anxiety, inertia, and the complexity of the market leading them to not switch to seek better deals when they become available. Whilst industry pushes for the taxpayer to subsidise multibillion pound loans[9] to further reduce the risks they face in serving their customers, Ofgem must consider the whole approach of its and Government's policies in balancing liabilities and risk in the energy market.

Almost half (45 per cent) of over-60s are worried about heating their home this winter[10] – equivalent to around 7.4 million people[11] – according to research for Age UK.[12] The survey, which took place in December, found that a third (33 per cent) of over-60s are worried about paying their energy bills this winter, with a similar proportion (32 per cent) worried about having to reduce energy use due to financial concerns.[13]

As Ofgem considers the scale of the Energy Crisis and the volume risk faced by suppliers it must be mindful of the wider consumer impact – particularly as it has proposed reforms which are likely to increase costs for consumers and water down existing price protections.

With around 1 million older households already in fuel poverty[14], Ofgem's focus must be on protecting those with the least ability to pay.

**In terms of the case for changing the Cap methodology** Age UK have several reservations. We are concerned that Ofgem have not exhausted current options for averting future crises. Better enforcement of existing rules, improved regulation and higher standards thresholds for market entry may be sufficient to avert future crises without the need for wider Price Cap changes. The onus is on Ofgem to demonstrate why it should be consumers who pay the price for the mistakes of a permissive regulatory regime.

Age UK also welcome any options Ofgem have for reducing the 8-month time lag between forward wholesale prices and their recovery through the Cap using the existing Price Cap method. This is not an endorsement of more drastic measures to reduce the time lag – such as quarterly Price Cap adjustments, which we discuss elsewhere (see our response to question 2, option 2). Instead, it is a challenge to Ofgem to use existing processes and the present composition of the Cap to reduce the 8-month delay while avoiding any negative consequences for consumers.

Age UK is also concerned with potential interactions between the different Price Cap reforms which have been proposed. We encourage Ofgem to better consider the cumulative impact of their proposals. For example, it is difficult to support any one of the options Ofgem has proposed in this call for input as we are aware that alternative options for changing the Cap are being put forward elsewhere, such as adaptations to the Cap methodology and related increases to risk allowances[15]. While smaller changes, such as increasing risk allowances, may have minimal consumer impact in isolation, the cumulative impact of multiple complex changes could be damaging.

There is a strong case for Ofgem exhausting current measures for mitigating market uncertainty and ensuring its regulatory framework is fit for purpose before enacting extensive Price Cap reform. Part of this process must involve greater recognition of the consumer crisis we are now facing. Current social protections for those on low incomes, in fuel poverty, and the millions of older people who have a greater need for energy, have shown to be wholly inadequate in the face of average bills likely to increase by 50% in 18 months. As part of its Price Cap review, Ofgem should commit to consulting on the design and implementation of a social tariff. It should also reinforce its commitment to the Cap and work with the Government to legislate for its extension beyond 2023.

**Question 2: what is the best way to tackle this issue whilst protecting consumer interests?**

Age UK have provided our views on each of the options proposed in this consultation. Subject to satisfying our concerns, our preferred option is to allow for alterations to the Cap value outside of the routine six-monthly changes in April and October under prescriptively defined exceptional circumstances. This preference is subject to Ofgem addressing our below concerns (see response to option 1) and the issues raised in our consultation response to similar Ofgem proposals[16].

**Option 1: Status Quo with Re-opener:** Ofgem have proposed two options for providing modifications to the Cap outside of the routine six-monthly changes in April and October under exceptional circumstances – the Price Cap re-opener and an automatic 'circuit-breaker'. Ofgem have better developed plans for the re-opener, with a consultation launched in December 2021[17]. We responded and outlined our clear objection to any increase to the Cap being permitted during the coldest months of November to March[18]. We reinforce this objection and extend it to any circuit-breaker option.

Present routine six-monthly changes to the Cap in April and October provide certainty for older consumers during the colder months. Those on the lowest incomes who are most likely to have a negative budget after paying for everyday expenses cannot be expected to find more money to cover their heating costs during the winter. Older people have higher heating costs[19], spend longer at home, and have a greater propensity to live with health conditions which require more heating or energy use[20]. This makes them particularly vulnerable to the impact of living in a cold home. Research conducted by Age UK in December 2021 showed that older people are anxious they will not be able to heat their home sufficiently this winter and that this will have a knock-on impact on their health[21]. They are also concerned that higher energy costs will reduce their ability to pay for other household essentials, such as food.

If Ofgem had the power to change the Price Cap under exceptional circumstances, it is certain they would have enacted an increase this winter. This would have pushed even more older people past their budgetary breaking point, leaving them unable to stay warm during the coldest months. With around 6 million older households living in hard to heat homes rated D-G for energy efficiency[22], Ofgem cannot risk a situation which unexpectedly forces even higher bills on them during the coldest months.

Beyond this, if Ofgem implements a re-opener option then we also question the need to make wider changes, such as including greater flexibility in the Cap to account for increased wholesale price volatility[23]. We recommend that Ofgem reconsider whether they still require wider reforms if they permit modifications to the Cap under exceptional circumstances.

Any decision to alter the Price Cap under exceptional circumstances will also need to come with a commitment to comprehensively signpost and promote the change to ensure consumers are aware. With older consumers more likely to be digitally excluded[24], and those who do not use the internet being more likely to be disengaged from the energy market[25], Ofgem must also commit to ensuring consumers understand any change via a range of online and offline channels. This must include print media, mail drops, and through community and voluntary organisations.

Ofgem's re-opener must also be reciprocal, with an exceptional energy price crash triggering a reduction in the Price Cap with the same urgency as a price spike prompts an increase. We are sceptical that a drastic reduction in energy costs would be seen as an exceptional circumstance which requires a change outside of the normal period. A drastic reduction in energy prices will have a high impact on consumers because they will no longer be paying a fair and cost reflective price for their energy. Standard Variable Tariff customers who are disengaged from the market[26] rely on appropriate protection by the

Cap. It would be unfair for suppliers to profit from these customers during an exceptional and unexpected price crash. If Ofgem is to enact these proposals and consider exceptional circumstances which negatively impact suppliers, it must provide equal weighting to similar circumstances which negatively impact consumers.

Scrutiny and review of any proposed changes is also essential. While we recognise changes under exceptional circumstances are likely to be enacted more quickly than usual, Ofgem must still be accountable to the public for any decisions taken. Charity and consumer groups must be given sufficient opportunity to scrutinise planned changes, challenge them and propose amendments. This must include a commitment from Ofgem to provide additional charity and consumer group engagement in the build-up to any Cap change and offer opportunities for consultation.

In addition to engaging with consumer representatives, Ofgem must also do more to ensure that consumers understand the impact of any changes to their bills. Energy is already a complex market and proposed reforms, alongside the adoption of new tariffs, and the transition to Net-Zero will only serve to make it more complicated. Half of households on standard variable tariffs were effectively disengaged from the energy market, and Ofgem must do more to reduce customer inertia and ensure the long-term affordability of essential energy costs.

**Option 2: Quarterly Updates:** Our concerns regarding any move towards quarterly updates to the Price Cap reflect the same issues we outlined in relation to option 1. However, quarterly updates also pose a more consistent threat to consumer confidence over the colder months – as quarterly changes would not be subject to the same exceptional circumstance tests. We strongly reinforce our position that any increases to the Price Cap value must be avoided during the coldest months of November to March.

**Option 3: Fixed term default tariff:** This proposal is for default tariff customers to be locked into their tariff for a minimum of six months – incurring exit fees if they terminate early. A switching window would be provided for consumers to move to a new tariff or supplier. While the price a consumer pays for their unit energy cost would be fixed for the duration of the contract, the level of the tariff for new customers would be set on a recurring monthly basis. This means that someone joining the tariff would face a new price level as prices adjust month by month. Ofgem have also put forward a 12-month fixed-term default tariff as an alternative.

Our major concern with these proposals is that 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.

Higher energy bills are more likely during this period as demand and prices often increase during the colder months[27]. This means that an older consumer who is market disengaged could be hit with a higher default tariff because their renewal date is in December, whereas a market engaged consumer could have ensured their tariff renews towards the end of the summer when prices are generally lower (e.g., by paying their exit fee and leaving their previous tariff early).

Given our strong objection to any price increases being passed onto consumers from November to March, the uncertainty this new proposal brings is unacceptable. It is also likely to 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 tariff[28] with Ofgem citing fixing the loyalty penalty as the major motivation for instigating the Cap[29]. Ofgem must also consider the circumstances of vulnerable customers who may not be as easily able to change supplier or tariff during the switching window and therefore may face higher prices or exit fees. Those who do not use the internet are more likely to be disengaged from the energy market[30] and older people are more likely to be digitally excluded[31]. The potential for variable renewal dates on fixed-term default tariffs risks compounding the barriers older people face in accessing the best deal.

If Ofgem did decide to press ahead with this proposal, then it should ensure that market-disengaged consumers could only renew their fixed-term 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.
Ofgem's proposals also raise questions as to whether default tariff exit fees are compatible with a fair and accessible energy market. Low-income households, particularly those on prepayment meters, will be disproportionately impacted by these fees. They may also reduce the incentive for suppliers to improve their efficiency and for consumers to switch to new tariffs and suppliers. Both principles are cornerstones of the Domestic Gas and Electricity (Tariff Cap) Act 2018 (Act) which instigated the Cap and outlined the guiding principles Ofgem should follow when setting it[32]. Ofgem must consider the compatibility of default tariff exit fees with the principles of a fair and accessible energy market while ensuring sufficient consumer support is in place to offset any negative impact for low-income households. For instance, it is not clear what rights a customer would have to freely switch outside of the dedicated window if they felt they were not being treated fairly by their supplier and wished to pursue a complaint against them.

**Other options:** Stakeholders submitted three additional options for consideration; a monthly direct pass-through, relative price cap across the market and a relative price cap within suppliers[33]. We agree with Ofgem's assessment that these proposed options do not presently provide sufficient consumer protections and in some cases may deviate from the Price Cap's original goals.

The monthly direct pass-through effectively means that consumer's energy prices would adapt each month to better reflect changes in suppliers' wholesale energy costs. This approach would eliminate much of the price protection and cost certainty consumers presently have under the existing Cap – particularly during the winter months when prices often increase[34].

We are similarly concerned that present relative price cap options relinquish too much of Ofgem's control over energy prices. This could unduly minimise supplier volatility risk by placing it disproportionately onto consumers. A relative price cap across the market[35] could result in exploitation by suppliers which may cause market distortions or negatively impact consumers. It would also require monthly changes to the Price Cap level which reduces cost certainty. The alternative of a relative price cap within suppliers is likely to mean a differential default tariff rate across different suppliers – resulting in some market disengaged consumers paying more than others.

**Question 3: which adaptations to the price cap are preferred and why, including any additional options not set out in this paper? (Please provide an outline description of how any alternatives would work)**

Having reviewed each of Ofgem's proposed reforms our preferred option out of those provided is to allow for alterations to the Cap value outside of the routine six-monthly changes in April and October under prescriptively defined exceptional circumstances. Our support for this option is conditional on Ofgem addressing our concerns (see response to question 2, option 1 and our previous consultation response[36]). Most importantly, we would only support this option if it excluded any Price Cap increases during the coldest months of November to March.

Finally, we wish to reinforce the possible negative consequences of interactions between the different reform options proposed by Ofgem in recent months, and the cumulative effect these would have on consumers. While minor changes may be needed to improve the suitability of the Cap, multiple complex changes combined could significantly erode consumer protections if not adequately scrutinised. Ofgem must be mindful of the interactions between the full range of Price Cap reforms proposed and how these may impact consumers.

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[4] Ofgem, 2021. Adapting the price cap methodology for resilience in volatile markets. Ofgem. [Online]. Available at: https://www.ofgem.gov.uk/publications/adapting-price-cap-methodology-resilience-volatile-markets. [Accessed 04/01/22]. Pg2.

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[9] Steven Swinford, 2021. Government loans to energy companies could protect the public from huge bills. The Times. [Online]. Available at: https://www.thetimes.co.uk/article/government-loans-to-energy-companies-could-protect-public-from-huge-bills-n0f8r8drs. [Accessed 11/01/22].

[10] Online survey conducted by Opinium on behalf of Age UK between 3rd and 8th December 2021. Sample of 2,000 UK adults (18+), weighted to be nationally representative.

[11] Population figure estimated by Age UK scaling up survey response using ONS mid-2020 population estimate.

[12] Online survey conducted by Opinium on behalf of Age UK between 3rd and 8th December 2021. Sample of 2,000 UK adults (18+), weighted to be nationally representative.

[13] Ibid.

[14] Based on households where the oldest person is aged 60+. BEIS, 2021. Fuel Poverty detailed tables 2021 (2019 data). Department for Business, Energy, and Industrial Strategy. [Online]. Available at: https://www.gov.uk/government/collections/fuel-poverty-statistics#2019-statistics. [Accessed 07/12/21]. Table 22.

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