Consultation Response

Statutory consultation on potential short-term interventions to address risks to consumers from market volatility

Office of Gas and Electricity Markets (Ofgem)

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About this consultation

Ofgem is consulting on measures it could employ to improve the resilience of the energy market and protect consumers. This consultation focuses on three temporary short-term measures Ofgem could take. These are: Requiring suppliers to make all new tariffs available to existing customers, allowing suppliers to charge exit fees on certain Standard Variable Tariffs (SVTs) and requiring suppliers to pay a Market Stabilisation Charge when acquiring new customers.

Key points and recommendations

- Ofgem must comprehensively evaluate existing options for mitigating market volatility and volume risk before enacting drastic short-term reforms.
- Age UK encourages Ofgem to further consider the cumulative impact of their proposals on consumers, including these short-term measures.
- Ofgem must commission an independent review into the role its own regulatory framework played in catalysing the recent Energy Crisis and supplier failures.
- If better enforcement of existing rules, improved regulation, and higher standards thresholds for market entry would avert future crises then we question the need for wider reforms such as the short-term measures proposed in this consultation.
- Subject to Ofgem comprehensively evaluating existing options for mitigating market volatility, our preference out of the three short-term options proposed is for suppliers to be required to make all new tariffs available to existing customers.
- Exit fees on SVTs are incompatible with a fair and accessible energy market with low-income and fuel poor older households being disproportionately impacted.

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 consultation[1]. A major motivation for Ofgem's proposal of short-term market interventions is the increased volume risk faced by suppliers during periods of price volatility. 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[2]. This makes it difficult for suppliers to predict in advance how many customers they will need to provide energy to and at what cost. 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[3].

Age UK's most recent response to Ofgem's call for input on 'adapting the Price Cap methodology for resilience in volatile markets' outlines our general view on the Energy Crisis, its impact on older consumers and what could be done to resolve it[4]. As a result, we have focused here on responding to the three short-term solutions proposed to mitigate the impact of recent market volatility on consumers.

However, we do wish to reinforce one of our key recommendations in the call for input[5]. Ofgem must carefully consider existing options for mitigating market volatility and volume risk before enacting drastic short-term reforms. This must include an independent review of the role Ofgem's regulatory framework played in the Energy Crisis. While some changes may be needed to improve the energy market, the cumulative impact of multiple complex changes could undermine consumer protections and unfairly shift market volatility risks away from suppliers and onto consumers. We encourage Ofgem to thoroughly consider the cumulative impact of their proposals, including these short-term measures. 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 reforms such as the short-term measures proposed in this consultation.

Therefore, our preference is for Ofgem to comprehensively review its existing options for mitigating market volatility. Once existing options have been exhausted, then our first choice out of the proposals provided is option 1 – requiring suppliers to make all new tariffs available to existing customers.

Option 1: Requiring suppliers to make all new tariffs available to existing customers

The first of Ofgem's proposals is a requirement for suppliers to make all new tariffs available to existing customers until the end of September 2022. The justification is that it will reduce the risk that suppliers will acquire consumers by aggressively reducing their prices for new customers. Suppliers would be disincentivised because any new cheap tariff option for new customers would also have to be extended to their existing customer base.

The benefit of this change is that Ofgem predict it will reduce the risk of supplier failures[6]. Their argument is that for market disengaged consumers this will actually provide an indirect reduction in their bill because they will have to cover less costs due to supplier failures and associated mutualisation costs. For market engaged consumers this option is less beneficial to their energy costs than Ofgem taking no action.

Of the three options proposed we are, on balance, most supportive of this proposal. But it raises one important issue – how to ensure fairness for those market engaged customers who use switching supplier as a means of keeping on top of their bills. The Government's Energy Retail Strategy[7] is heavily focused on empowering consumers to switch tariff or supplier. Improving the switching framework is considered a core component of improving the energy market and addressing the loyalty penalty paid by the nearly two thirds of consumers who do not switch from their default tariff[8]. As a result, Ofgem will need to consider other options for keeping consumer bills down if switching is to be disincentivised. This could include Ofgem recommending that the Government exempt VAT on consumer energy bills and call for direct payments from Government to vulnerable consumers through the Cold Weather Payment scheme.

Ofgem will also need to be mindful of the gaming risks. For instance, suppliers who have a less market engaged consumer base may be advantaged by this policy. They may continue to aggressively reduce prices on the assumption that a smaller proportion of their existing customers will switch. This gamble could either unfairly benefit suppliers with a more market disengaged customer base or result in greater volume risk and increased chance of supplier failure.

Option 2: Allowing suppliers to charge exit fees on certain Standard Variable Tariffs

The second of Ofgem's proposals is for exit fees to be added to Standard Variable Tariffs (SVTs, sometimes referred to as Default Tariffs) until September 2022, subject to sufficient market volatility being identified. This proposal would not include those on deemed contracts where they made no active decision as to who provided their energy (e.g. where a consumer has been moved provider via the Supplier of Last Resort process or recently moved into a new property).

The rationale for this proposal is to mitigate the risk that increasing numbers of consumers will exit their SVT and take up a fixed-term deal. This could result in suppliers being left with more costly energy expenses, based on the predicted number of SVTs they expected to have, but then not having enough customers to pay for it. In a worse case scenario this could lead to an increased number of suppliers going bust.

Age UK believes that exit fees on SVTs are incompatible with a fair and accessible energy market. Low-income and fuel poor households, particularly those on prepayment meters, will be disproportionately impacted by these fees. Not only will it risk them avoiding seeking cheaper energy deals, if market conditions stabilise before September, but they will also have to spend a higher proportion of their income on exit fees than higher earners. For context, the overall median fuel poverty gap, representing the amount needed to come off bills to lift a household out of fuel poverty, stands at £126[9]. Retired households have the highest median fuel costs and the highest fuel poverty gap compared to households of other employment statuses[10]. This means that an SVT exit fee could still represent a significant cost burden for older fuel poor households.

If Ofgem do pursue this option, they will need to make specific proposals for how much the maximum value of an exit fee will be and ensure this cost is minimised as much as possible. Existing licence conditions for fixed-term contract exit fees require that they are proportionate and do not exceed the economic cost to the supplier of the consumer exiting their tariff early[11]. While we agree that these are good conditions for assessing the value of an exit fee, our concern is that interpretations of what is 'proportionate' and what the estimated cost implications are, could vary greatly across suppliers. As a result, Ofgem should set a maximum limit to any SVT exit fee and keep it as low as possible. We are cognisant that minimising the exit fee may reduce the impact of this policy solution, but this is another reason why alternative solutions from SVT exit fees should be pursued where possible.

SVT exit fees are designed to reduce the volume of consumers switching supplier and may also reduce the incentive for suppliers to improve their efficiency. Both consumer switching and improved supplier efficiency are cornerstones of the Domestic Gas and Electricity (Tariff Cap) Act 2018 (Act) which instigated the Energy Price Cap and outlined the guiding principles Ofgem should follow when setting it[12]. Ofgem must therefore consider the compatibility of SVT 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.

Option 3: Requiring suppliers to pay for a Market Stabilisation Charge when acquiring new customers.

Ofgem's final proposal is to require suppliers to pay for a Market Stabilisation Charge when they successfully acquire a new customer. This fee would be paid to the supplier who lost the customer and the policy would only be enacted between April and September 2022 if wholesale energy prices fell far below expectations. The rationale is similar to option two in that it will reduce SVT volume risk for losing suppliers. It would also only be enacted subject to sufficient market instability being identified and would be tapered based on the degree of wholesale price volatility, with the fee gradually increasing as wholesale prices decrease.

Our concern regarding the Market Stabilisation Charge is that these Charges may still negatively impact consumer bills. Suppliers may pass on the costs of the Charge to their consumers directly or they may choose to absorb the cost, which could further increase the risk of supplier failure. In practice this may reduce the likelihood of suppliers acquiring new customers so they can avoid having to charge uncompetitive tariff levels to cover the additional cost – thereby reducing volume risk. But this raises the same questions outlined in our response to SVT exit fees about whether the policy is conducive to a fair and accessible energy market for low-income and fuel poor older consumers (see response to option 2).

However, we are aware that Ofgem's proposal to taper the cost of charges based on the degree of any price drop may allow tariff switching to continue to a greater extent than if SVT exit fees were used. This could minimise any negative impact on the energy market and the ability for consumers to switch tariff. A Market Stabilisation Charge would also be less complicated for consumer bills, with the burden for administering the Charge sitting entirely with suppliers. As a result, we are more supportive of this option than applying SVT exit fees.

Option 4: The 'do nothing' option.

Ofgem proposed a fourth option of taking no additional action. This option was proposed because wider stabilisation measures are already being proposed elsewhere. These measures may be sufficient to avoid the need for the three suggested short-term measures. As outlined in our introductory remarks, we reinforce the need for Ofgem to comprehensively evaluate existing options for mitigating market risks before enacting drastic short-term reforms. If existing mechanisms are sufficient then taking no additional action may be appropriate.

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[5] Age UK, 2022. Call for input response: Adapting the price cap methodology for resilience in volatile markets, Ofgem. Age UK. [Online]. Available at: https://www.ageuk.org.uk/our-impact/policy-research/publications/consultation-responses/. Under 'Safe at Home' section, 2022.

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