

Friday 10 May 2024

Ofgem Future of Domestic Price Protection Discussion Paper - UW response

Supply and Retail Market, Ofgem
future_price_protection@ofgem.gov.uk

Utility Warehouse was one of the first ‘challenger’ brands when it entered the retail energy market over 20 years ago, and we have a unique perspective in that we operate across numerous regulated markets: energy, telecoms and insurance. Today we serve over 1 million households.

UW overarching view

UW is a strong supporter of price protection and we agree that the correct starting position for Ofgem and DESNZ is that price protection should remain a feature of a future, more dynamic market, and that without it, we risk a return to the price exploitation of disengaged customers.

We support the adaptation of the cap to accommodate changes in customer diversity in time, and we strongly believe - for the reasons set out in our response - that this adaptation should be as much as possible an extension of two key features of the cap: universal and stringent. Further, we caution that the current pace of consumer behaviour change does not appear to yet warrant a major and urgent overhaul of the fundamentals of default protection. We therefore support a gradual pace of change that allows time for new learnings to be taken into account.

Consultation questions

Q1	<p>Do you have any reflections on our list of the cap’s successes and challenges?</p>
	<ul style="list-style-type: none"> ● We agree with Ofgem that price protection should remain a feature of a future, more dynamic market, and that without it, we risk a return to the price exploitation of disengaged customers. ● We agree with Ofgem that the purpose of the cap is to ensure default customers pay a fair price for their energy, but that it cannot tackle the problem of energy affordability for low-income or vulnerable consumers. ● We agree with Ofgem that the price cap did not stifle competition. We fully agree with Ofgem’s conclusions set out in 2.27 i.e that price certainty, non-price competition, and increases in alternative tariffs are all factors that customers value and that are good for a resilient marketplace in which competition is healthy and sustainable. ● We agree that some suppliers were exposed to volatile energy prices because they had not hedged enough wholesale energy to meet their customers’ demand (2.14) ● We disagree that the cap led to additional costs for consumers during a period of volatile energy prices. The cap does not dictate how suppliers can and cannot hedge and therefore should not be blamed for any supplier shortcomings in hedging approach. The extent to which competition is delivering good outcomes for consumers in the retail market should not be measured on price alone. ● As we know from recent market experience e.g. the collapse of Bulb, intense price competition can lead the market to poor customer outcomes. The failure of energy supplier Bulb was ultimately grounded in the fact their competitive angle was centred around its ‘novel’ hedging approach aimed at delivering cheap pricing for its consumers. This is therefore an important learning to take forward as we adapt the cap for the future. Ofgem should also consider the link between customer inertia and hedging strategies when it considers the type of market it wants to achieve. As Ofgem notes, substantial long-term hedging is not a perfect solution as it is challenging to ensure that long-term hedging is compatible with more engaged customers that may move on and off a default tariff. ● In regard to the points made by Ofgem in paragraph 2.19 regarding hedging strategies, we would highlight that while suppliers were hedging for 1-2 years ahead this would not have been for 100% of their energy requirements meaning that high market prices would still have fed into the hedge. So, even if they were not as spiky, they would have fed in for longer meaning that the customer would have paid the same amount overall. Having the regulated cap in place meant that the Government was able to step in with the EPG to manage affordability rather than having to manage a range of still very expensive prices. This highlights the fact that the cap is not in place to manage affordability - or shield customers from high prices (this is a role for targeted affordability measures); instead, the cap is in place to ensure fair cost-reflective prices. ● In response to Ofgem’s observations in 2.22, we would highlight that before the cap was in place, suppliers still followed similar hedging patterns because competition means that responsible suppliers do not want the risk of having a hedge price significantly higher than their competitors. Therefore the cap has not driven suppliers to adopt similar hedging patterns; this is driven by the nature of competition and the volatility of the wholesale market.

Q2	<p>Do you believe that the growing diversity of electricity consumption patterns will make it challenging to retain a flat, universal and stringent price cap? How quickly do you think this will materialise and with what impacts? What evidence can you provide to support your view?</p>
	<ul style="list-style-type: none"> • Whilst we recognise there has been a gradual change in the diversity of electricity consumption patterns, we do not believe this is substantial enough or that there is evidence that it will change dramatically in the medium-term to justify concerns that it will challenge the retention of a flat, universal and stringent price cap. • Overall, while there are advancements towards more diverse electricity consumption, it is crucial for Ofgem to recognise that the current price cap provides a necessary protection. Ofgem should adopt a gradual, low risk pace of change to protect consumers and allow for new learnings to inform policy. • We have summarised our justification for this below; please also refer to our response to Q7: <p><u>Slow adoption of new technologies:</u> Despite the increasing popularity of new low carbon technologies and Electric Vehicles (EV), their adoption rate remains low. For instance, the Government’s heat pump strategy is behind schedule and under criticism due to the lack of an overarching engagement campaign. Additionally, while Electric Vehicle take up is increasing, they still only represent a fraction of all cars on the road (c. 3%). In smart, we are still only at 60% national coverage, with low customer engagement being a key barrier. We caution any more regulatory change or investment being made to align to ambitious government targets at this stage.</p> <p><u>Infrastructure limitations:</u> Not all customers have the necessary infrastructure in their homes to change their consumption habits effectively. While a customer may have an EV, we need to consider that around 25% of households have no access to off-street parking, and around 20% of houses are privately rented and so there is a significant proportion of the population unable to access a smart charge point for which they are billed.</p> <p><u>Consumer behavioural inertia:</u> Consumer behaviour tends to change gradually rather than rapidly. It is therefore important to adopt a gradual pace of change. We think it is fair to assume that disengaged customers, protected by the default cap, are less likely to be near-term adopters of low-carbon products and therefore the cap does not need to change quickly. It is also default, inactive, customers who are most likely to be low-income or vulnerable and thus most in need of protection against exploitation.</p>
Q3	<p>What plans do suppliers have to launch ToU tariffs and to incentivise customers to shift their electricity consumption once MHHS is implemented?</p>
	<ul style="list-style-type: none"> • No comment. We would be happy to discuss this with Ofgem.
Q4	<p>How quickly and at what scale do you expect customers, especially those with large flexible loads such as EV and solar/battery users, to take up ToU tariffs once MHHS is implemented?</p>
	<ul style="list-style-type: none"> • Irrespective of the pace of uptake, if Ofgem is considering regulatory interventions, it should be mindful of the fact that it will be difficult for suppliers to determine whether a customer has an EV and difficult to monitor. Even if a customer did have an EV, we need to consider that around 25% of households have no access to off-street parking, and around 20% of houses are privately rented and so there is a

	<p>significant proportion of the population unable to access a smart charge point for which they are billed. Therefore it would be wrong to force that customer onto an EV TOU tariff. We don't believe regulation in this space is appropriate or practicable.</p> <ul style="list-style-type: none"> • We would also encourage Ofgem to be cautious that investing too much too quickly based on ambitious Government targets rather than reality, may not be in consumers best interests (escalation of costs, reduction of benefits case). We also caution against making assumptions about sudden improvements in the levels of engagement and behaviour change needed to drive Net Zero; there are ongoing Government programmes that provide valuable lessons. • For example, the smart meter rollout is behind schedule with still only 60% national coverage and costs rapidly escalating; similarly the Government's heat pump strategy is behind schedule and under criticism from the National Audit Office due to the lack of an overarching engagement campaign. Finally, while Electric Vehicle take up is increasing, they still only represent a fraction of all cars on the road (c. 3%). Policy development should also take account of the fact that many EV owners do not charge their vehicle at home. Combined with this, several factors such as technological advancements, consumer awareness and education on ToU tariffs, market competition and ToU tariff offerings will impact the pace at which customers are likely to select ToU tariffs.
Q5	<p>In addition to the factors set out in this chapter, are there any other important changes that might affect the ability of the current default tariff cap to achieve its objectives?</p>
	<ul style="list-style-type: none"> • In addition to the factors set out in the chapter, there are several other factors that need to be considered. Without accommodating these factors, there is a risk that the default cap methodology will create tensions in the market going forward: <ul style="list-style-type: none"> <u>i) Recovery of debt-related costs:</u> It is important to ensure that debt is appropriately and accurately recovered under the price cap, both historic debt and the ongoing build up of debt. Setting the debt related costs at an appropriate level will allow suppliers to adapt to shocks or changes in the regulatory environment, ultimately supporting higher service standards. <u>ii) Accurate allowance for operating costs :</u> A weighted average is by far the most appropriate and accurate way to reflect an efficient industry cost. It is a practical mechanism that best achieves a fair, cost-reflective, and achievable benchmark in the best interests of consumers. Setting a benchmark excessively low will not protect consumers if it results in poor customer service outcomes due to under-funding and lack of investment in the transition to net zero. <p>A weighted average approach removes the risks associated with using a lower quartile benchmarking approach. For example, a supplier may only be achieving lower quartile in one component because it is achieving a higher quartile in another. It could also be the case that a supplier appears to be in the lower quartile in debt-administration because it is cutting corners. At a time when investment in debt administration is so vital, Ofgem should avoid building in risk of an unreflective cap that could drive underinvestment or irresponsible behaviour, and set a dangerous precedent.</p> <u>iii) Investment in innovation:</u> It is essential to maintain an attractive market for both new entrants and existing operators. This requires Ofgem to ensure there is scope within the cap that encourages and accommodates investment in innovation. Further to this, achieving efficiency requires investment in improving activities and

	the cap should accommodate for this.
Q6	Do you agree that we need to retain some form of price protection in the retail market?
	<ul style="list-style-type: none"> • Yes, and we support the continuation of universal default protection based on a stringent methodology. UW is a strong supporter of price protection and we fully support Ofgem’s starting point that price protection should remain a feature of a future, more dynamic market, and that without it, we risk a return to the price exploitation of disengaged customers.
Q7	Do you have views on which of the three key parameters – the cap being flat, universal and stringent - should be relaxed when considering future price protection options?
	<p><u>Overarching view on key parameters</u></p> <ul style="list-style-type: none"> • We believe Ofgem should pursue the option that allows for the most gradual pace of change, the continuation of existing well understood regulatory/industry processes, the clearest and simplest rules for consumers and the market to navigate, and importantly the most technically robust methodology that will allow suppliers to recover their costs. In our view, the approach that delivers this is the continuation of a stringent methodology, the continuation of the universality principle - we have set out our justification below - and the introduction of a Static TOU tariff for engaged default TOU customers to sit alongside the existing flat rate default tariff cap. <p><u>Universality</u></p> <ul style="list-style-type: none"> • The concept of universality is essential if the cap is to continue to prevent the exploitation of inactive customers; without it, customers not captured by the cap will face the risk of being overcharged and the cap would no longer be delivering ‘default protection’. We cannot risk a return to a market where disengaged customers are exposed to overcharging. • Any adjustment to the methodology should align to the policy objective, which is to ensure fair pricing in the default market, not to address affordability. We therefore disagree with any deviation that seeks to target (or exclude) certain customer groups. Vulnerable price support should be delivered via a targeted, progressive, government-funded mechanism. • Further, in the same way as the introduction of the EPG was enabled by the existence of the price cap, we believe that to deliver a social tariff/discount, there would need to be a price benchmark already in place against which to discount prices for the targeted group, which emphasises the case that price protection and a social tariff are complementary policies. • As Ofgem points out, excluding certain groups could be construed as penalising customers who have made positive changes to take up low carbon technology (EVs, heat pumps). This would be a counterproductive message for the sector and could further damage the pace of the smart rollout. <p><u>Stringent</u></p> <ul style="list-style-type: none"> • A stringent, bottom-up assessment of costs is the most technically robust approach to producing a reliable benchmark on which to set default prices so that consumers are protected from unnecessary costs and exploitation. In the scenario that we have two default caps (TOU and flat), it would seem appropriate to use the same bottom-up approach in both cases.

	<ul style="list-style-type: none"> • While we appreciate that a bottom-up approach brings challenges, we believe Ofgem's conclusions of 2018 are as relevant today as they were then - a price-based approach or a market-based reference price cannot provide a valid comparator that can be used for setting the cap for the entire market. A bottom-up assessment of costs also has the benefit of being similar to the price controls used elsewhere in the sector. • It provides Ofgem certainty about the exact costs that are included in the benchmark and how those costs are treated. Relying on price data e.g. a market-basket approach means prices would depend not just on suppliers' costs, but on their pricing strategies and levels of competition in the market. As Ofgem set out in its consultation back in 2018, this approach doesn't allow an accurate reflection of an efficient supplier's long-run costs. UW strongly supports a bottom-up approach as a greater reliance on cost data (as opposed to price data) allows for a more technically robust and reliable methodology on which to set default prices. • Unlike the other options presented, the transparency of a bottom-up approach, with an industry benchmark published on a quarterly basis, has wider benefits across the sector. For example, third party organisations, consumer bodies (Money Supermarket etc.), sector analysts (Cornwall etc). have transparent data on which to base their analyses and consumer advocacy work. This ultimately raises awareness of what drives energy prices and how consumer bills are affected; which in turn helps educate and advise consumers, further contributing to better consumer engagement. Additionally has indirectly brought more clarity to the sector and reduced the previous unhelpful narrative in the media that worked to reduce customer trust and engagement in retail. • Finally a less significant, but still relevant point to consider is that deviating from the existing approach risks losing the technical knowledge and familiarity gained over the last six years across both Ofgem and the wider sector; a new approach would likely come with new implementation challenges and risks of error.
Q8	What are your views on options discussed? Do you have any preferred options or combination of options?
	<ul style="list-style-type: none"> • We believe Ofgem should pursue the option that allows for the most gradual pace of change, the continuation of existing well understood regulatory/industry processes, the clearest and simplest rules for consumers and the market to navigate, and importantly the most technically robust methodology that will allow suppliers to recover their costs. In our view, the option that delivers this is the continuation of a stringent methodology, the continuation of the universality principle, and the introduction of a Static TOU tariff for engaged default TOU customers to sit alongside the existing flat rate default tariff cap. • Our early thinking is that it would make sense for Ofgem to publish a price cap for a flat rate default tariff and a static TOU default tariff, but for suppliers to decide how to apply those tariffs to their customer base (which would be made clear via T&Cs), rather than for Ofgem to prescribe that certain customers should default onto a certain default tariff.
Q9	In particular, which options or combination of options do you think would best protect vulnerable customers?

	<ul style="list-style-type: none"> • The UK is in an enduring cost of living crisis combined with high energy prices - we fully support the provision of bill support for consumers that are struggling to pay their bills, particularly low-income and vulnerable. However, we are aligned with the entire industry that this type of price support should be delivered via a targeted, progressive, government-funded mechanism. We don't believe default tariff options should vary depending on a customer's circumstances. Clear, simple, price protection should be universally in place for all default customers. • Further, in the same way as the introduction of the EPG was enabled by the existence of the price cap, we believe that to deliver a social tariff/discount, there would need to be a price benchmark already in place against which to discount prices for the targeted group, which emphasises the case that price protection and a social tariff are separate, but complementary policies.
Q10	How should consumers with large flexible loads, mainly EV and solar/ battery users, be treated with regards to future price protection?
	<ul style="list-style-type: none"> • We do not think that future price protection should vary depending on a customers technology choice or on their circumstances. Future default price protections should be simple, cost-reflective, and universally in place for all default tariff customers. • It would be difficult to determine whether a customer has an EV and difficult to monitor. We don't believe regulation in this space is appropriate or practicable. Further, even if a customer did have an EV, we need to consider that around 25% of households have no access to off-street parking, and around 20% of houses are privately rented and so there is a significant proportion of the population unable to access a smart charge point for which they are billed. Therefore it would be wrong to force that customer onto an EV TOU tariff.
Q11	Are there any additional options that we haven't, but should be considering?
	<ul style="list-style-type: none"> • No comment