

## Consultation Response

### Which? response to the Ofgem's discussion paper on the future of domestic price protection

Submission date: 10/05/2024

#### Summary

Which? appreciates the opportunity to respond to this initial discussion paper on the future of domestic price protection.

Overall we agree that the current default tariff cap has been successful at addressing the loyalty penalty harms it was designed to tackle. Disengaged consumers have paid less than they otherwise would have absent the cap, and we think it likely that price exploitation would return for disengaged customers if price protection was removed. Even when switching was at its highest, 40% of consumers remained disengaged with the market and there will always be at least a substantial minority who need protection from the kind of price exploitation identified by the CMA in the 2016 Energy Market Investigation.

It is plausible that the cap could become difficult to maintain in its current form as usage patterns become more diverse. However, we encourage Ofgem to undertake further detailed analysis of different future scenarios so that policy development can be informed by a better understanding of potential future outcomes both under the current cap methodology and with alternatives. It is difficult to reach firm conclusions on the need for change without at least some indicative analysis on the scale of trade-offs to be made.

There may be cases in which it is appropriate to relax some elements of the three key cap parameters set out in the discussion paper: flat, universal, and stringent. All of the options presented come with trade-offs however, and again we would welcome further analysis on some of the options to better understand how they could actually work in practice and what the level of trade-offs might be. Our initial thoughts on some of the options discussed are:

- **Relaxing flatness.** Currently only a very small minority of consumers have any experience of using energy flexibly. It may be appropriate for future price protection to take the form of a static ToU in some cases, but not universally. We would not support forms of price cap which force consumers onto unfamiliar or unsuitable tariffs given the limited experience among the population at large, and vulnerable consumers with limited ability to flex usage would need safeguards.

- **Relaxing the universal parameter.** Only providing price protection for vulnerable consumers would seem to move away from a cap which aims to tackle the loyalty penalty. There may be a case for stronger protections for vulnerable consumers compared to others, but a holistic approach would consider affordability and not just protection for the disengaged.
- **Relaxing stringency.** Relative caps warrant further analysis, but our concern is that they could still lead to a wide spread of prices across the market and leave disengaged consumers with some suppliers much worse off than others. We support an extension of the ban on acquisition-only tariffs on fairness grounds, but do not see it as an adequate replacement of the default tariff cap.

We understand that this discussion paper is intended as an early step in considering changes to price protection as the energy market develops. We would welcome further engagement with Ofgem to discuss this work as it moves forward.

## Full response

### Evaluating the cap today

#### 1. Do you have any reflections on our list of cap's successes and challenges?

We generally agree with the analysis set out in the discussion paper. The evidence suggests that the cap has been successful at addressing the loyalty penalty harms it was designed to tackle. Disengaged consumers have paid less for their energy than would have been the case absent the cap, while competition was preserved in the more engaged segment of the market prior to the start of the energy crisis. The evidence also points towards increased efficiency of large suppliers over the cap period, likely driving benefits for consumers.

In addition to the analysis presented in the paper, there are two factors under-examined in the assessment of the cap's success. Firstly, the potential pro-competitive impact of the cap by levelling the playing field between suppliers with and without large inactive customer bases. Prior to the cap's introduction, the large incumbent energy suppliers (i.e. those which existed at the time of privatisation) could cross-subsidise their acquisition deals by charging more to their inactive customer base. This raises barriers to entry and expansion for non-incumbent suppliers who have a more active customer base and therefore need to price more keenly to avoid customers switching away. The cap may therefore have allowed greater expansion among the non-incumbent firms in the market. A balanced view of the competitive effects of the price cap should include discussion of this pro-competitive potential.

Second, the role of the cap in protecting consumers during the energy crisis. While the cap was not designed to address affordability issues, it did help with the policy response to rapidly rising prices by both delaying the pass-through of wholesale costs to consumers and acting as an instrument that could be adapted towards affordability through the Energy Price Guarantee. The delays in wholesale cost pass-through did have consequences for supplier financial stability, and may not have been the optimal policy instrument. However, it gave the government, Ofgem and consumers time to prepare for a very steep rise in prices. Ofgem and the government should consider how any changes to price protection may or may not perform this role in future should it be needed.

We would welcome further analysis about the relationship between the cap and customer service. We have ongoing concerns about levels of customer service in the energy sector. Our surveys, as well as those from Ofgem and Citizens Advice reveal widely varying standards of customer service across suppliers, with some falling well short of what consumers expect. Cuts in customer service could be a risk of a price cap mechanism which needs to incentivise efficiency gains. On the other hand it could encourage greater competition on quality if it reduces price differences between suppliers. We would encourage further examination from Ofgem, as few conclusions can be drawn from the analysis in the discussion paper.

## Evaluating the current cap for the future

**2. 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?**

We agree that changing consumption patterns alongside the move to MHHS could create some tension in operating all three of a flat, universal and stringent cap. Based on the analysis in the discussion paper however, it is not clear how quickly this might happen nor how material the impacts might be.

We would welcome further analysis from Ofgem of different scenarios that could emerge and what impacts they could have under the current cap methodology, or alternatives. For example, how diverse do consumption patterns need to be within and across suppliers to make the current cap difficult to operate, and how much would the cap need to rise in order to allow all suppliers to operate efficiently. It is not possible to reach firm conclusions on the need for change without at least some indicative analysis on the scale of trade-offs to be made.

**3. What plans do suppliers have to launch ToU tariffs and to incentivise customers to shift their electricity consumption once MHHS is implemented?**

We do not have any specific intelligence on suppliers' plans post-MHHS. However, it is notable that currently the by far most common ToU tariffs on offer are two-rate EV charging tariffs. To our knowledge there is still only one dynamic time-of-use tariff on the market (Octopus Agile). Beyond time-of-use tariffs, some suppliers already offer incentives to shift usage as part of their existing fixed tariffs, for example OVO's Power Move scheme, British Gas's peaksave Sundays, or Octopus Power-ups. These could be considered a form of 'time-of-use' but are structured differently to fit more easily alongside the fixed tariffs that consumers are used to.

It is still unclear which tariffs or models will most appeal to consumers and become widespread. Many smaller suppliers currently offer no tariffs which encourage flexibility. Even after MHHS, suppliers could still choose to favour fixed tariffs and hedge their wholesale costs across their portfolio.

**4. 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?**

We expect that consumer take-up will proceed at a moderate rate given the scale of change in behaviour that is required. Currently the vast majority of consumers have no experience with ToU tariffs. According to the DESNZ Public Attitudes Tracker, in Summer 2022 12% of households reported being on some kind of time-of-use tariff. Most of these (9%) were on a dual-rate tariff, 1% on a dynamic tariff and 2% on another tariff or didn't

know. Even among EV-owning households, who are among the best-placed to take advantage of flexible tariffs, only 33% were on a time-of-use tariff.

There are many factors which could affect the speed of take-up, most of which are currently skewed towards slowing rather than accelerating progress. These factors include:

- **Technology take-up, including smart meter adoption.**

Consumers will get limited benefit from shifting their energy use unless they have the technology to benefit e.g. electric vehicles, heating, hot water, solar, batteries etc. Consumers will adopt these technologies over time, but the pace will depend on up-front costs, running costs, and the relative cost of fossil-fuelled alternatives. This relationship between flexibility and technology is somewhat circular, as the potential for flexible energy usage can also improve the case for adopting the technology. For example, heat pumps offer greater savings over gas boilers when used with a time-of-use or type-of-use tariff.<sup>1</sup>

None of this smart technology can be operated flexibly however if consumers do not have smart meters. As of the end of 2023, only around 6 in 10 domestic electricity meters were smart and operating in smart mode.<sup>2</sup> This places a hard limit on take-up that can't be surpassed unless more consumers actually have operational smart meters. Currently 4 in 10 are excluded from benefitting regardless of any other factors.

- **The savings on offer, and the ability for consumers to understand and compare the benefits**

The relative cost of ToU tariffs against static tariffs will substantially drive take-up. Greater savings will lead to more consumers finding it worthwhile to engage and try new offers. Trying something new involves costs for consumers, including time, effort and risk of something going wrong. Financial savings will need to be at a level to overcome those barriers. The greater the savings available, the more likely consumers will be to take up offerings.

However, potential savings can only influence consumer behaviour if consumers are aware of them and able to make comparisons. Currently, even relatively simple two-part EV tariffs are not on price comparison websites, and consumers have few tools available which allow them to use their smart meter data to make more accurate comparisons. Take-up of new offers will be stymied if consumers don't have tools which enable them to make easy predictions of the savings on offer across the market. Suppliers themselves may also need to make better use of consumers' smart meter data in order to identify customers who could benefit from greater flexibility.

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<sup>1</sup> Which? (2023), [A heat pump might be a lot cheaper than you think: here's how](#), and Carbon Brief (2024) [18 misleading myths about heat pumps](#)

<sup>2</sup> DESNZ, [Smart meters in Great Britain quarterly update December 2023](#)

Non-targeted marketing will also play a role in the speed of take-up. Suppliers may choose to market flexible tariffs aggressively, or not at all. Third parties could also play a role in marketing if they have access to the data required to help consumers make good tariff choices. Price comparison websites have historically played an important role encouraging switching through advertising on television and online and they may have a role in guiding consumers through a potentially complex tariff choice.<sup>3</sup>

- **Consumer protection, the consumer experience and trust in energy suppliers**

Good consumer protections which prevent bad experiences will be necessary to encourage take-up. Risk and loss aversion mean consumers will be reluctant to try new products if they don't trust how they're marketed or how they'll be protected if something goes wrong. Research also shows that product crises that generate negative publicity at a single firm can damage sales across the whole market. Bad experiences can be especially damaging for take-up at the early stages of innovation, when social learning and social influence mean that good or bad experiences lead to substantial spillovers to other consumers.<sup>4</sup> If consumers face issues with mis-selling or being moved onto inappropriate tariffs, then the resulting scandals could be highly salient and damage trust in the market and take-up of offers.

Good quality customer service will be vital. Consumers will likely need additional support from their supplier as they move onto new tariffs. Consumers may need help understanding which offer is most suitable for them, how their prices vary, querying smart meter readings, or understanding/querying their bills. Even current billing leaves many consumers confused about what they're paying,<sup>5</sup> with a lack of clarity in communication affecting trust.<sup>6</sup>

**5. 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?**

We have nothing to raise at this stage.

## **Options for evolving price protection for the future**

**6. Do you agree that we need to retain some form of price protection in the retail market?**

Yes, we agree with Ofgem's conclusion that "if price protection was removed completely, we would likely see a return to price exploitation of inactive customers, as existed before the cap."

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<sup>3</sup> CMA (2015), [Energy Market Investigation: Price Comparison Websites](#)

<sup>4</sup> See chapter 3 of our report on [Consumer Protections and Economic Growth](#) for more discussion on the link between innovation and consumer protections

<sup>5</sup> Which? (2023), [Energy bills transparency](#)

<sup>6</sup> Which? (2023), [Talking energy: identifying principles for clear customer communications](#)

In the 2016 Energy Market Investigation, the CMA described harm resulting from the large incumbent energy suppliers having “unilateral market power over their inactive customer base.” This inactive customer base still exists in significant numbers. Data from Ofgem shows 15% of electricity accounts (excl. pre-pay) with the largest suppliers have been on a default tariff for three years or more, and for some suppliers, these accounts make up more than a fifth of their total customers.<sup>7</sup> We think it very likely that price exploitation of the least engaged would return absent some form of price protection.

It is notable that even in 2021, when customer switching was very high by historical standards, 40% of consumers had still not engaged with the market over the past 12 months. This is a good indication that there are limits to customer engagement and shows that the disengaged proportion of consumers will remain at best a substantial minority. Given the current situation of around 9 in 10 consumers being on a default tariff, there is no guarantee that we will return to as many as 60% of consumers engaging in the market. A future smart data scheme might help to unlock some additional switching, but nonetheless it is likely that a significant portion of consumers will remain disengaged and on default tariffs.

**7. Do you have views on which of three key parameters - the cap being flat, universal and stringent - should be relaxed when considering future price protection options?**

**AND**

**8. What are your views on options discussed? Do you have any preferred options or combination of options?**

Without seeing a full analysis, it is difficult for us to reach a full view on the level of trade-offs that might need to be made. It is still unclear at what levels of consumption diversity the current bottom-up cap approach would start to cause difficulty, and what the actual implications would be for consumers. We would welcome more analysis on many of the issues presented so that the full implications of each can be assessed in more detail. Nonetheless below we have some initial thoughts on options presented.

### **Options moving away from a flat cap**

#### *Static ToU cap*

This could have merits for consumers with large flexible loads and experience with flexible tariffs. However, we are not convinced that it works as a universal mechanism for consumers. Most consumers have no experience with flexible tariffs, and defaulting disengaged consumers risks causing substantial harm. Unfamiliar consumers may not understand ToU tariffs or find they cannot shift their energy usage in a way that takes advantage of the price incentives. In Australia there have been moves to place consumers onto ToU tariffs by default, and a recent news story has shown this leading to substantial

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<sup>7</sup> Ofgem [Retail Market Indicators](#), number of domestic electricity accounts by supplier (excluding PPM): standard variable, fixed and other tariffs. Information correct as of January 2024



bill shock for some consumers.<sup>8</sup> One consumer saw their quarterly bill unexpectedly more than double to \$2,000. Stories like this have potential to seriously undermine trust in ToU tariffs and the smart meter rollout. Capping static ToU rates would mitigate risk of harm somewhat but could still leave consumers open to bill shock from using energy unwittingly at high peak rates.

Nonetheless, it would be reasonable for consumers who are on fixed-term static ToUs to have price protection of this form if they default at the end of their contract. This could be beneficial as an EV driver for example would not default onto a flat tariff by mistake and face bill shock from higher overnight charging rates.

### *Dynamic ToU cap*

A dynamic ToU cap would expose consumers to too much volatility to be suitable as a form of price protection. Consumers seeing and reacting to daily changes to their energy prices would be a huge change and one that is likely to cause issues for many consumers who already have limited engagement with their energy supply.

### **Options moving away from a universal cap**

#### *Target on vulnerability*

Relaxing universality to target protection at vulnerable consumers only does not seem compatible with a policy goal to reduce loyalty penalty harms. As referenced in our response to question 6, the harm identified by the CMA was from a market failure that means inactive consumers face a level of price exploitation. Therefore tackling that harm means protecting inactive consumers, regardless of vulnerability.

However, we do acknowledge that part of what makes the loyalty penalty especially unfair is that it disproportionately impacts vulnerable and low income consumers. The individual impact of the loyalty penalty on these customers is on average more severe than for others. So there could be an argument for relaxing universality by providing very strong protection for vulnerable consumers while having a weaker or more flexible level of protection for other consumers. However presently there are two large limitations to Ofgem achieving this:

- Protection for vulnerable or low income consumers should be centred around ensuring affordability, not just tackling loyalty penalty harms. A social tariff or mechanism similar to what was proposed by Citizens Advice/SMF would be the best way to do this.<sup>9</sup> Ofgem is not well-placed to introduce a social tariff, as the required cross-subsidy would either unfairly burden other consumers or provide a smaller-than-necessary subsidy to those in need. Warm Home Discount (WHD) is a case in point. It is targeted at too few consumers and set at too low a level. A properly targeted scheme would require public funding, and so would best be led

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<sup>8</sup> ABC News (2024) [Energy Companies Under Fire Over Time of Use Rates](#)

<sup>9</sup> Citizens Advice/SMF (2023), [Fairer, warmer cheaper](#)



by DESNZ. We would urge Ofgem to take a stronger position on this and make the case to government for a social tariff to protect vulnerable consumers.

- We are not confident that Ofgem has the means to target vulnerable consumers in a way that would not unfairly exclude some people. The discussion paper mentions the Priority Services Register and the WHD, both of which seem inadequate for targeting well. WHD applies to just 2.8 million household in receipt of certain means-tested benefits, while the PSR requires consumers to request to be added to the register. Creating an adequate targeting mechanism would mean Ofgem and/or suppliers devoting substantial time to collecting information about households, which again would be better taken up by central government. Government plans in the 2024 Spring Budget to move the base of the High Income Child Benefit charge to a household income basis may also open opportunities for HMRC to hold household-level income data, which could then enable better targeting of low income households. But still more would need to be done to capture consumers vulnerable for other reasons like disability or ill health.

Unless these can be reconciled we would not favour a system which relaxes universality on the basis of vulnerability.

### *A bottom-up cap excluding customers with certain ToU or type of use products*

We do not agree that consumers should be excluded from price protection on the basis of which technology they own or use. Many more households will own EVs over the coming years and that should not be sufficient for removing protections. It would be more appropriate to retain price protection but for the form to be different, e.g. as a static ToU cap as discussed above. However, even in this case it would be preferable for the form of price protection to follow the consumer's prior tariff rather than just be based on their ownership of technology.

Given limited consumer experience with ToU tariffs, Ofgem and suppliers should in the first instance be encouraging consumers who can benefit to move onto ToU as an active choice to make financial savings. Otherwise there are substantial risks of harm for people if consumers are automatically removed from price protection or forced onto an unfamiliar tariff.

## **Options moving away from a stringent cap**

### *Margins cap*

We would not support capping supplier margins as a form of price protection. It would remove incentives for suppliers to improve efficiency, and is not compatible with a competitive market.

### *Ban on acquisition-only tariffs*

Extending the ban on acquisition-only tariffs addresses issues with fairness, but not the core loyalty penalty harm experienced by the long-term disengaged. The BAT improves

fairness by allowing existing customers access to their supplier's best tariffs but would not prevent a disengaged customer from being exploited unless they engaged in an internal switch. There are many customers who have been on default tariffs for 3+ years and it is not clear how the BAT would tackle the harm to those consumers.

## *Within-supplier relative cap*

There is a substantial risk of suppliers with large inactive customer bases having an incentive to raise acquisition prices rather than limit their default tariff costs. It could potentially still leave a significant loyalty penalty between suppliers, where customers of an incumbent with a large inactive base face much higher prices than the customers of a newer entrant with more active consumers.

It would be useful to see more analysis on what optimal strategies would be for suppliers under versions of this cap and therefore what the plausible spread of prices across the market could be. This is something that could be modelled.

## *Market-based relative cap*

We agree with Ofgem that there could be risks with suppliers gaming a relative cap. Similar to the within-supplier cap option, it would be helpful to see some analysis or modelling of how such a mechanism might work in practice and what different suppliers' optimal strategies might be. It is also unclear how such a market-based cap could work in a market with a much greater diversity of tariffs.

## **9. In particular, which options or combination of options do you think would best protect vulnerable customers**

Again this is difficult to answer without seeing greater detail and analysis. Further, many issues related to vulnerability are about affordability rather than tackling loyalty penalty harms (outlined further in our response to question 8).

If price protection moves towards time-of-use tariffs it will be necessary to think about the implications for vulnerable consumers who cannot reasonably shift usage away from peak times. This could be consumers with medical conditions who need to run special equipment, or those with electric heating and specific needs to keep their home above a certain temperature at all times of day, and with limited potential to flex usage. For example, a household with electric space heaters, poor insulation and medically vulnerable consumers cannot be expected to shift use away from peak times when it is cold. It will be imperative that these customers not be defaulted onto inappropriate tariffs which expose them to much higher bills or dangerous rationing of heating.

## **10. How should consumers with large flexible loads, mainly EV and solar/battery users, be treated with regards to future price protection?**

As covered in our answer to question 8, we do not think that consumers should be excluded from price protection on the basis of which technology they own or use. These

technologies will become much more widespread over the coming years, and their ownership does not prevent consumers from experiencing loyalty penalties. It would be more appropriate to retain price protection but for the form to be different, e.g. as a static ToU cap as discussed above. However, even in this case it would be preferable for the form of price protection to follow the consumer's prior tariff rather than just be based on their ownership of technology. Maximum efforts should be made to help consumers make active choices which unlock the flexible potential of their technologies, cutting their own bills and increasing system efficiency for everyone else.

We also encourage Ofgem to give proper consideration to households with storage heaters and other forms of electric heating and/or electric boilers. These consumers have high flexible potential, and could make substantial savings if they use flexible tariffs. But it is not clear that adequate attention is being given to these households in comparison to customers taking heat pumps, electric vehicles, solar and batteries. That is particularly concerning given consumers using electricity as their main fuel for heating are more than twice as likely to be in fuel poverty compared to gas heated households.<sup>10</sup> It will be very important that price protection is suitable for these customers, especially given the concerns that have been raised about the functioning of the current price cap for Economy 7 customers.<sup>11</sup> There are already signs of a two-tier ToU market developing where the best value ToU tariffs are restricted to people with EV home chargers or heat pumps.

## **11. Are there any additional options that we haven't, but should be considering?**

Nothing to add at this time.

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<sup>10</sup> SSN/Grid Edge Policy, [An electric heat pathway: looking beyond heat pumps](#)

<sup>11</sup> Grid Edge Policy/Glen Dimplex, [It's a lottery: how Ofgem's price cap fails Economy 7 customers](#)

## About Which?

Which? is the UK's consumer champion, here to make life simpler, fairer and safer for everyone. Our research gets to the heart of consumer issues, our advice is impartial, and our rigorous product tests lead to expert recommendations. We're the independent consumer voice that works with politicians and lawmakers, investigates, holds businesses to account and makes change happen. As an organisation we're not for profit and all for making consumers more powerful.

### For more information contact:

Matt Gardner  
Senior Economist  
Matt.Gardner@which.co.uk

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