Sustainability first

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Future Price Protection – response to Ofgem Discussion Paper

Dear Ofgem team

Sustainability First is a charity and think-tank focused on social and environmental issues in the energy and water sectors. We have published and engaged extensively over many years on policy, regulatory and consumer issues for the household electricity demand-side, including on what fair approaches to tariff development could look like. We were members of the former BEIS / Ofgem Smart Systems Forum and shaped both the ESO's Power Responsive programme and the ENA Open Networks project.

We welcome what we see as a thoughtful discussion of the issues around future price protection in a world where we need consumers to be more flexible in their use of energy. Market-wide half hourly settlement (MHHS) should provide the incentive on suppliers to help drive this. We recognise that variations in the costs to serve for their different customer bases will make it increasingly challenging for Ofgem to set a cap that is stringent (keeping prices to the absolute minimum), universal (covering all customers) and flat (based on a single rate for 24 hours), while ensuring that suppliers can cover their legitimate costs.

However, we are disappointed at the failure to properly engage with the Economy 7 aspects of the current cap – both to address problems facing a significant group of consumers today and as a source of learning for the future. Our work on Economy 7[1] highlights that even a basic time-of-use (ToU) tariff cannot be squeezed into the framework of a flat cap (which is how it is managed today). The cap therefore needs to evolve to properly include Economy 7 / a simple ToU tariff (alongside a single rate tariff which we see continuing as the default for disengaged customers for some time to come).

In terms of the trade-off between a universal cap and one that is more stringent we would argue for a more targeted, stringent cap but with some form of principles-based regulation to ensure wider consumer protection, in particular as we look for more consumers to move onto potentially more complex time of use tariffs. Targeting the cap would ensure that those on low incomes who are most in need of price protection, can get the lowest prices. Principles-based regulation should ensure that all customers are treated fairly, giving them confidence to move to ToU tariffs, while giving more space for the market to innovate and bring forward attractive offers. While suppliers already have an obligation to ensure that customers are on a tariff that is suitable for their needs, our work on Economy 7 demonstrated that this is not being effectively enforced[2].

We expand on these points below (together with some wider reflections) and have provided answers to the consultation questions in the attached annex.

[1] https://www.sustainabilityfirst.org.uk/fet

[2] See case study in our 2023 response on the price cap Work Programme - here

Economy 7 should be explicitly addressed as a part of this work

We were deeply disappointed at the lack of discussion around the issues with Economy 7 (and other similar tariffs) in the price cap, aside from a short footnote acknowledging the concerns we have raised and linking to the Grid Edge Policy report, "It's a Lottery: How Ofgem's price cap fails Economy 7 Customers". At around 3 million households (c 10% of domestic customers) who are predominantly in rented accommodation or on low or very incomes, this is not a niche that can simply be ignored. Modern electric storage heat has a valuable role to play in meeting our net zero targets as a flexible source of electric heat that is well suited to smaller, well insulated properties. Looking to address the issues with Economy 7 in the price cap today would both deliver short term benefits to a disadvantaged group and help Ofgem in understanding the real practical challenges with having a basic (static) ToU tariff in the price cap. We recognise that to fully address the issues we have raised may need a change to the legislative framework but this is a further reason for starting that thinking now.

The latest Economy 7 tariffs under the price cap, taken from the Money Saving Expert website[3] show that suppliers' day and night rates still vary massively. Specifically, MSE quote (national average figures):

	Night	Day
Utility Warehouse	8.43p	33.88p
E.on	10.95p	32.06p
British Gas	14.64p	29.38p
Ovo	17.1p	27.60p

While it has been suggested that this range benefits Economy 7 customers who can then choose a tariff to suit their usage pattern, we would reiterate that these are typically disengaged customers and the purpose of the price cap is meant to be to protect customers who do not switch. While all these tariffs would comply with the cap assuming a day:night split of 58:42, the Grid Edge Policy report makes clear that in practice customers most customers will have a very different pattern (depending whether or not they actually still have storage heating) and hence how much they actually pay will vary considerably. It cannot be the case that a 100% difference in the night rate is justifiable in terms of cost to serve which is the basis on which the price cap should be set.

Given how important flexibility is to enabling an efficient electricity system going forward, we need customers to have confidence that they will be treated fairly if on a time of use tariff and there is a real opportunity for Ofgem to learn from the example of Economy 7 how this should (or should not) be done.

Our provisional view, which we encouraged Ofgem to explore in our response on the price cap work programme, is that Ofgem needs to explicitly set the rates for the different periods not rely on a single figure (which then relies on using a weighted average). Further work is also needed (as Ofgem are proposing) to understand how wholesale costs vary by time of day including looking at the assumption on the peak / baseload split.

[3] https://www.moneysavingexpert.com/utilities/economy-7/ (as at April 2024)

The trade-offs in future price cap goals

In terms of the key question at the heart of the consultation we agree with Ofgem's assertion that it will be impossible to maintain a cap that is flat, universal and stringent going forward. In our view the answer is to have a more targeted, stringent cap combined with wider (less stringent) price protection in the form of principles-based regulation, for example. The aim should be to allow innovation in the development of new time of use tariffs in ways that will encourage customers to engage. While this will mean slightly less short-term price protection it should deliver longer term benefits.

In terms of the scope of the cap, we are clear that, as set out in our response to DESNZ, there still needs to be a single rate default tariff to protect vulnerable customers on the price cap who may struggle to engage with a ToU tariff – or low-income customers who would be worse off on such a tariff. Longer term we accept the aim should be to move to ToU as the default once it is a more familiar concept and alternative protection in terms of a social tariff or other support is available for those on low incomes.

We are also clear that the future price cap needs to include a basic time of use tariff – like Economy 7 given the number of existing (typically low income) Economy 7 storage heat customers who are reliant on these tariffs to make their current (low-carbon off-peak) heating viable. However this tariff needs to properly reflect the differences in wholesale costs at different times which the current price cap does not do.

Economy 7 (and Economy 10) should be the initial focus for a basic ToU tariff given its existing role in the market and the very different demand profile of customers with storage heating. However, it is perhaps not best suited for the generality of customers who do not have a large load they can move to overnight charging. A peak rate (between 5pm and 8pm) might be more relevant in managing the system capacity issues and also leave households with more scope to manage their demand to keep costs down. However significantly more work is needed to understand how costs vary over the day (and how that is expected to evolve) – as well as how demand profiles vary between (and within) customer groups and the sorts of tariffs that customers are comfortable with. As a principle we would suggest that the price cap should be following not leading in terms of tariff innovation given the sorts of customers who we believe should be the priority for price protection.

Other issues

As well as questions around price cap design, the consultation touches on a number of related points which we would encourage Ofgem to consider:

- **Opt-in to MHHS**: The Ofgem discussion paper sets out very clearly the risks around adverse selection where customers with peaky loads (such as an EV owner who wishes to charge at peak) would shelter behind a flat rate price capped tariff, pushing up the costs for customers at large. We have previously raised the same concern in relation to the decision to allow customers to opt out of providing their half-hourly data for MHHS. We see a risk that these peaky customers will opt out of MHHS either because they are concerned about being forced onto a ToU tariff or are actively encouraged by their supplier to opt out (as this would reduce their cost to serve). It is important that Ofgem monitors the levels of MHHS opt-in/out to identify any gaming and to provide the evidence for the ICO to allow a move to this data being mandatory to support an efficient energy system.
- **Capacity charge**: In the Appendix to the discussion paper Ofgem summarises the position in a number of overseas markets. This highlights that in a number of these markets there is a

capacity charge for domestic customers. Sustainability First has consistently argued for capacity charges to be introduced as part of network charging reform. We see capacity charges as reflecting the real underlying costs of a low carbon energy system (including the significant generation and grid capacity growth needed to meet net zero). It would also be fairer than the current reliance on fixed standing charges. We would urge Ofgem to explore this option further as part of thinking about future default tariff arrangements.

- **DUOS**: Linked to the point above, the discussion paper looks at the implications of MHHS but does not mention the current work looking at reform of DUOS charges and how they might evolve. Currently DUOS (like other network charges) does vary by time of day (on a red-amber-green basis with time periods that vary by DNO area). This is taken into account in setting the price cap using standard profiles but ultimately one would hope to move to ToU tariffs where these price signals are properly reflected. With some discussion about a move to dynamic DUOS it is important that thinking on future price protection takes account of potential changes to network charging.
- **Improved demand-side data**: There is some very limited evidence[4] that lower income households on average have slightly flatter profiles but the variations within demographic groups are much greater than the variations between groups. Further work is needed to properly understand the distributional impacts of the ToU options identified in the paper. In particular, our PIAG project[5] highlighted the need for Ofgem / DESNZ to have access to granular smart meter data linked to socio-demographic data in order to be able to look at key distributional questions like this – and to identify the scale of potential price increases some individual customers might face and the scale of detriment if customers are not on a suitable tariff for their needs.

We hope these reflections have been helpful and would be happy to discuss further if that would be useful.

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Associate Sustainability First

Cc Judith Ward, Zoe McLeod

[4] See Grid Edge Policy report on the distributional impacts of MHHS drawing on earlier Sustainability First research using CLNR data.

[5] PIAG – Follow-up Project Report 2023 - https://www.sustainabilityfirst.org.uk/images/Sustainability_First_-_PIAG_-_Follow_Up_Report_-_Final_070223.pdf

PIAG Snapshot - https://www.sustainabilityfirst.org.uk/images/publications/piag/PIAG_Snapshot_Report_2017-2021.pdf

Appendix: Response to questions

Evaluating the cap today

Q1. Do you have any reflections on our list of the cap's successes and challenges?

The list does not mention the problems with Economy 7 which the Grid Edge Policy report highlights.

We have also observed that having a stringent and universal cap has meant that over recent years Ofgem has had to put a lot of effort into fine tuning the way it treats detailed cost elements, often driven by pressure from suppliers. In our view this is not the best use of Ofgem time and has been at the expense of addressing more strategic, customer focussed issues around Economy 7.

Evaluating the current cap for the future

Q2. 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 it will be increasingly challenging to meet all three goals.

However, we would argue that there is already significant diversity of load with night storage heaters that the current cap has not been able to handle.

Future increases in diversity of load patterns will be driven by the uptake of EVs, solar and heat pumps which has been slower than eg previous FES scenarios would suggest. However, this could change with a new government and does need to be addressed if we are to hit net zero.

Q3. What plans do suppliers have to launch ToU tariffs and to incentivise customers to shift their electricity consumption once MHHS is implemented?

We have no direct knowledge but are surprised that beyond Octopus Energy no suppliers are as yet offering time of use tariffs at scale (other than Economy 7) albeit there are a number of EV specific tariffs[6]. With the advent of MHHS we would have expected suppliers to start wanting to test the market and learn. This suggests that the development of ToU tariffs could be slow even once MHHS is launched.

Q4. 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?

For EV users there are significant savings that can be earned by charging at night and the availability of EV specific tariffs is likely to help customers recognise the benefits. However there will still be some customers who value the convenience of charging when they want and the income profile of EV owners means they may be less motivated to trade off convenience for savings. The current uptake of ToU tariffs across EV owners should provide some guide.

[6] https://www.moneysavingexpert.com/utilities/ev-energy-tariffs/

For solar and battery there is an added complication of the interplay with export tariffs.

Q5. 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?

No comment

Options for evolving price protection for the future

Q6. Do you agree that we need to retain some form of price protection in the retail market?

Yes. The problems that gave rise to the cap in the first place – of a loyalty premium / higher prices for disengaged customers – will still be there. And given the cost of living crisis and rising debt levels the implications of this for lower income households is particularly acute. These customers clearly need continuing price protection – as well as there being a need for a proper social tariff.

However, for the generality of customers as the discussion paper highlights there is a trade-off between robust price protection which can deliver short term benefits and a more active retail market, offering innovative time of use tariffs, that will deliver longer term cost savings as part of a smarter more efficient energy system. Price protection for other customers should be less stringent and aimed at building confidence of customers to re-engage in the market, to explore ToU tariffs and make informed choices. This points to a broader set of priorities including:

- Enforcing, and potentially strengthening, the obligation on suppliers to ensure that customers are on a suitable tariff for their needs (drawing on the learning from Economy 7);
- Ensuring it is clear where claimed savings from a ToU tariff are dependent on changing behaviour;
- Providing an independent tariff comparison tool that can deal with ToU tariffs;
- Looking at how best to protect customers on dynamic tariffs against extreme price spikes.

Previous Citizens Advice work on Legacy Time of Use Tariffs[7] and thinking by CSE[8] based on their Smart and Fair project are helpful in highlighting other areas for focus

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?

A price cap based on a flat tariff does not work for Economy 7 customers today. There should be a flat tariff option for most customers but for Economy 7 (and eg Economy 10) Ofgem needs to specify separate rates for the different time periods.

We should also move away from a universal cap to one that is targeted but stringent.

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7 https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/False%20Economy%20(LToU%20tariffs%20and%20restricted%20meters%20report)%20-%20draft%202%20(2).pdf

8 https://www.cse.org.uk/news/response-to-default-energy-tariffs-for-households-call-for-evidence/

Q8. What are your views on options discussed? Do you have any preferred options or combination of options?

"flat" – we are clear that there still needs to be a single rate tariff available under the price cap along with a static tariff / tariffs to meet the needs of customers currently on Economy 7 or similar. Other static tariffs could be included in due course. We can see no case for including a dynamic tariff under the price cap. Dynamic tariffs will be difficult for disengaged / vulnerable customers to cope with. There are a range of factors that need to be considered including how customers are notified / when, whether the tariff is fully dynamic or just includes some super-peak days (as in France) etc Designing a dynamic tariff that balances cost reflectivity with ease of customer understanding and acceptability should be the role of the market, not the regulator.

"universal" – we would support a targeted cap aimed at low-income households and those facing particular affordability challenges because of disability etc. We recognise that there are practical challenges in doing this but would be disappointed if this was seen as a reason not to try (building on the general support for social tariffs which face the same difficulty).

The other option of focussing on particular use cases is interesting and in our response to DESNZ we argued for a default time of use tariff for EV users to encourage off peak charging (and to avoid other customers picking up the costs of these customers charging at peak). However we do not see these customers as requiring the price protection offered by a stringent cap.

"stringent" – as noted above we would support a less stringent form of price protection for the wider customer base. We do not have a particular preference for the mechanism used but are aware that any prescriptive form of relative cap or margin cap carries risks. However, in our view these are all useful tests of whether or not a supplier is treating customers fairly in setting prices. The choice as we see it is therefore between a strict (but not stringent) rules-based form of price protection versus a principles-based one where these tools could be used as part of assessing compliance and where it may be easier to take the particular supplier circumstances into account.

Q9. In particular, which options or combination of options do you think would best protect vulnerable customers?

As noted above we would support stringent price protection targeted on low-income / vulnerable households. This would give the highest level of protection to those who need it most.

We see flat tariffs as essential alongside a static ToU tariff(s) to meet the needs of Economy 7 / Economy 10 customers, noting that households with storage heating are disproportionately on low incomes, older or living in rented accommodation (based on Ofgem's archetype analysis).

Q10. How should consumers with large flexible loads, mainly EV and solar / battery users, be treated with regards to future price protection?

These are customers who clearly have both the financial resources and interest to engage in acquiring these technologies and as such it is hard to see that they need price protection in terms of a price cap. That said, in our response to the DESNZ consultation, we argued that ToU tariffs should be the default for EV users – to avoid other users picking up the costs of them charging at peak times. If there were to be an element of mandation around use of ToU tariffs for EVs then arguably some form of back-stop price protection would be needed.

For heat pumps the considerations are more complex as these can be installed by housing associations, for example. However, numbers remain limited and the options for flexible use are still not clear. For low-income households we would expect these customers to still be covered by the cap (using either a flat rate tariff or a basic, static ToU tariff).

Q11. Are there any additional options that we haven't, but should be considering?

Principles based approaches

As an alternative to a stringent cap, we would encourage Ofgem to also look at the option of a more general obligation to treat customers fairly including in the level of tariff charged (which is explicitly excluded at present). For dynamic tariffs this could include limitations on extreme peak pricing as seen in the international examples (and as Octopus Agile already does).

There may also be lessons to be taken from the current regulation of deemed tariffs and the obligation that they should not be "unduly onerous"[9] (noting of course that for domestic customers deemed rates are currently covered by the price cap).

Wider protections

The original work by Ofgem on the consumer impacts of MHHS[10] included some helpful reflections on possible market developments (such as heat as a service which could deliver the benefits of flexibility without consumers needing to engage) and wider protections needed.

In particular, transparency and lack of complexity are vital. This will require a more sophisticated approach to tariff advice and tariff comparison to accommodate more ToU tariffs. The evidence from Citizens Advice research and Grid Edge Policy reports[11] is that there is still relatively low understanding among Economy 7 (and other similar tariff) customers about how their tariff works – the hours to which it applies, whether it covers all their usage or just heating etc. This reinforces the need for a stronger emphasis on the information and support that suppliers have to offer.

We have also seen, in our recent work on Economy 7, strong evidence of customers being left on Economy 7 tariffs even when they no longer have storage heating so they are paying potentially hundreds of pounds more than they would on a single rate tariff. Suppliers do already have an obligation to ensure that tariffs are suitable for the customer's needs and Ofgem has reminded suppliers of that obligation in the context of Economy 7. However, with a greater prevalence of ToU tariffs Ofgem needs both better data and to be more proactive in ensuring that suppliers are treating customers fairly (in particular those who are in vulnerable situations).

[9] https://www.ofgem.gov.uk/sites/default/files/2023-11/Guidance%20on%20Deemed%20Contracts.pdf

[10] https://www.ofgem.gov.uk/sites/default/files/docs/2020/06/potential_consumer_impacts_following_the_implementation_of_market-wide_half-hourly_settlement_-_final.pdf

[11] The original report on storage heaters and the more recent report on Economy 7 and the price cap