National Energy Action (NEA) response to DESNZ's Default energy tariffs for households: call for evidence

About National Energy Action (NEA)

National Energy Action [1] works across England, Wales, and Northern Ireland to ensure that everyone in the UK[2] can afford to live in a warm, safe and healthy home. To achieve this, we aim to improve access to energy and debt advice, provide training, support energy efficiency policies, work on local projects, and coordinate other related services which can help change lives.

Background to our response

National Energy Action feels strongly that default tariffs play an important role in the protection of vulnerable consumers. NEA has been involved in policy work to maintain and reform the energy price cap for several years. This has included working with Ofgem to create the initial safeguard tariff, helping to design the default tariff price cap, and to then evolve it to ensure it offers adequate protections for fuel poor households, through responses to consultations and bilateral engagements.

Since 2021, prices for consumers have risen dramatically. Despite government intervention in the form of support for energy bills, consumers are now paying 49% more than they were at the beginning of the crisis. This amount would be higher if not for the price cap, which allows consumers to feel protected and to feel as though they are being treated fairly.

National Energy Action fully supports the evolution of the retail energy market in offering lower carbon, lower cost bills. To achieve this, default tariff reform may be necessary. However, innovation in this regard should not come before consumer protection.

Summary of our response:

Maintaining the benefits of the current price cap

Research conducted by Public First explored public attitudes on the impact of the price cap. More than half of surveyed households believe that the price cap is the only thing stopping energy suppliers from charging more, that it protects vulnerable and low-income households and that the price cap means that consumers are not charged unfair prices.[3]

The price cap was introduced to reduce loyalty premiums, or to reduce the cross-subsidisation of fixed term contracts from default tariffs. Its introduction has helped to tackle distrust among consumers that they are being charged a fair price. The public understands and values the price cap, especially the protection it has offered during the energy crisis.

Transparency in the make-up of the price cap means that prices are more easily explained to consumers and organisations such as National Energy Action can scrutinise pricing decisions in a more evidence-based way. This is important for ensuring markets work in the interests of consumers. Prior to the price cap, increases in energy costs were often explained by suppliers to be the result of policy cost increases but these increases were not properly evidenced. Inadequately explained price rises can result in mistrust from the public over policy levies. Mistrust in policy costs can have a material impact on energy bills. Carbon Brief has estimated that cuts to energy policy schemes since 2013 have added over £2.5bn to energy bills, an outcome that is the direct result of efforts to cut policy costs.[4]

There is considerable risk that public perception is damaged through reforms to default tariff arrangements. Whatever course of action is decided upon for default tariff reform, DESNZ has a role to play in maintaining transparency and confidence. It is important that consumer groups and the consumers themselves can understand exactly why prices are changing

when they change. Reforms should also carefully consider impacts on vulnerable, low-income households.

The price cap is not, however, a perfect arrangement for default tariffs. Most notably, for households with storage heating, and those with a multi-rate meter, the price cap does not adequately pass through the benefits of off-peak consumption. There are around 1.4 million households that use storage heating in Great Britain[5]. For households with a multi-rate meter, NEA shares concerns with other organisations about how they are treated in the price cap. Existing default tariff arrangements do not work particularly well for these households, especially because of the absence of advice and tools available for these households to load shift. Around 3 million households are on these multi-rate arrangements, and they are not seeing the full benefit of lower wholesale electricity costs at night and face a lottery in terms of what they pay with significant variations in Economy 7 tariffs depending on supplier, region, and payment method. There is an opportunity in default tariff reform to lower costs for these households without adding costs to bills of others.

Around 86% of consumers are currently on default tariffs. Though the price cap was not intended to provide deep price support for consumers, it is clear that consumers rely on the price cap as a form of price support. This call for evidence does not explore how deeper price support could work for low-income consumers in the future, which is important for maintaining consumer trust and confidence. DESNZ should recommit to consulting on the introduction of a social tariff, or other form of deeper price support for low-income consumers. The introduction of a social tariff could de-risk the process of reform for default tariffs, by ensuring that many of the households who currently rely on the energy price cap receive protection through another mechanism.

The risk of bad practice re-emerging

The case for reform focuses on harnessing the benefits of low carbon energy. Changes introduced through the Mandatory Half-Hourly Settlement (MHHS) programme will impact how the wholesale component of energy bills are passed through to consumers. Energy bills consist of many more components. Excluding the price caps delivered in the height of the energy crisis, the wholesale component of the typical household's energy bill amounts to less than 50% on average. The remaining 50% of energy bills are compiled of several components, including network costs, policy costs, operation costs, VAT and several additional allowances[6].

Since the introduction of the price cap, Ofgem has played an important role in determining how these costs are recovered by suppliers. Much focus of recent policy work has been around a fairer recovery of costs across different payment methods. For instance, prepayment standing charges have been permanently levelised with direct debit standing charges, mitigating the impact of standing charges on prepayment households.[7] Ofgem is considering further measures to reduce unfairness across payment types, such as levelising debt-related costs between standard credit and direct debit households.

Assuming there could be multiple forms of default tariffs in the future (such as having one dynamically priced and one statically priced default tariff), there is a risk that energy suppliers could apportion a higher level of fixed costs to households without smart technology. Households who cannot afford smart technology may be more likely to face affordability pressures and debt. If energy suppliers take a cost-reflective approach to recovering the costs of servicing debt that they face, the households who are more likely to be in debt will face higher levels of fixed costs compared to households with smart technology. Not only would households be paying higher costs on account of having less ability to respond to price signals, but this could create significant disparity between the affordability of energy for households with or without smart technology. The result could be unequal access to affordable energy.

Ofgem should continue to determine how costs are recovered by energy suppliers. Changes to cost recovery have significant impacts on low-income consumers, potentially reducing affordability pressures to the benefit of all consumers. Future price protection arrangements should pass through the benefits of a renewables-based system, but there must also be price protection for costs not related to the wholesale price of energy. This can be achieved while allowing the market to reward households for using energy smarter. In terms of the principles for future default tariffs, **Principle 2 in the consultation document aims to protect consumers from unnecessary complexity and costs. This principle should be broadened to cover the issue of fairness in terms of how fixed costs are distributed between customers.**

A continuing role for Ofgem is required

While the discussions of reforms to default tariff arrangements are in their early stages, it is valuable to consider what might be required to transition from default tariffs determined by the price cap process to an arrangement which could operate parallel to, or instead of, the price cap. In either case, to ensure that default tariffs do not once again drive unfairness, Ofgem must have a role in regulating default tariff offerings. This is consistent with public opinion. Only 7% of the public believe that the government should not be involved in setting energy prices at all, while 49% believe the government should only be involved in the setting of energy prices to prevent them from being set too high.[8]

Ofgem should continue having a role in setting expectations for what fair pricing is, particularly regarding how non-wholesale costs are allocated to households. This is important for ensuring that suppliers are incentivised to continue making efficiency gains and reducing fixed costs as opposed to moving costs around in order to generate more competitive tariffs for engaged consumers.

Additionally, the introduction of MHHS could impact households differently based on whether or not they have a smart meter, and whether or not it is fully operational. The smart meter rollout is not a factor that is fully in the control of households, it is therefore important that Ofgem and DESNZ continue to drive the replacement of traditional meters with smart meters so that households can access the benefits that smart meters offer, including through half-hourly settlement. It is important that once installed, meters are working as they should. DESNZ should work with Ofgem to ensure that this is reflected both in the policy underpinning the rollout, and the way in which suppliers are obligated to deliver it.

Answers to the CfE questions

Question 1 - Do you agree with these principles?

NEA broadly agrees with the intention behind these principles, though are concerned about unintended outcomes that could arise from them. Under the price cap, wholesale costs tend to consist of less than 50% of the average consumer's annual bill. These principles are underpinned by the aim of passing through the value of a low-cost renewables-based system, but it is important that the principles also apply to how fixed costs, such as operating costs, debt-related costs and network costs, are distributed amongst consumers.

Regarding principle 3, that households should not be exposed to excessive costs from the inefficient use of high-consuming items by other consumers, many vulnerable users cannot efficiently consume electricity owing to mental and physical health conditions (such as use of medical equipment or incapacity to change consumption patterns). These same consumers may be more likely to use default tariffs. This is not necessarily out of choice, but the result of several factors making them less likely to regularly search for fixed tariffs which might offer better value. Principle 2, that default tariffs should protect consumers from unnecessary complexity and costs, is therefore very important in this regard.

It is also important to consider where excessive costs from inefficient consumption might cause or worsen debt. Traditionally, Ofgem has adopted a cost-reflective approach to recovering debt-related costs. If default tariff reform results in a segregated market between households based on their ability to use energy efficiently, or based on what technology a household has, there is a risk that some vulnerable consumers will be double-penalised.

Principle 1, which states the market should be free to reward households for using energy smarter, should be balanced with consideration for how to ensure low-income, vulnerable households do not face unfairly higher costs. The unintended result of reforms to how wholesale prices are passed through to consumers, in addition to the perpetuation of a cost-reflective allocation of additional costs incurred by suppliers, could create a gap in energy prices between households.

Beyond the principles set out in the CfE, another important principle to follow is maintaining the two important positive aspects of the current price cap: consumer confidence and transparency.

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Research conducted by Public First explored public attitudes on the impact of the price cap. More than half of surveyed households believe that the price cap is the only thing stopping energy suppliers from charging more, that it protects vulnerable and low-income households and that the price cap means that consumers are not charged unfair prices.[9]

Transparency in the make-up of the price cap means that prices are more easily explained to consumers and organisations such as National Energy Action can scrutinise pricing decisions in a more evidence-based way. This is important for ensuring markets work in the interests of consumers. Prior to the price cap, increases in energy costs were often explained by suppliers to be the result of policy cost increases but these increases were not properly evidenced. Inadequately explained price rises can result in mistrust from the public over policy levies. Mistrust in policy costs can have a material impact on energy bills. Carbon Brief has estimated that cuts to energy policy schemes since 2013 have added over £2.5bn to energy bills, an outcome that is the direct result of efforts to cut policy costs.[10]

There is considerable risk that public perception is damaged through reforms to default tariff arrangements. Whatever course of action is decided upon for default tariff reform, DESNZ has a role to play in maintaining transparency and confidence. It is important that consumer groups and the consumers themselves can understand exactly why prices are changing when they change. Reforms should also carefully consider impacts on vulnerable, low-income households.

Question 3 - With current licence conditions, do you believe most domestic consumers will continue to default onto single-rate standard variable tariffs in future or are suppliers likely to consider using Time of Use tariffs as a default?

Current licence conditions necessitate that suppliers' default tariffs comply with price cap levels set by Ofgem unless an exemption is granted (for instance, Evergreen Supply Contracts). NEA therefore understands that suppliers could not use Time of Use tariffs as default without licence changes which would require a decision by the Secretary of State to end the price cap.

Question 4 - Should protections be placed on the type of default tariffs that suppliers use for domestic consumers? If so, what should those protections be; for example, is there a case for limiting default Time of Use tariffs to static rather than dynamic pricing?

Before determining whether it is appropriate to place protections on the types of default tariffs that suppliers can offer, it's necessary to fully explore the potential options for reform. There is not currently an adequate understanding of options for default tariff reform to know at this stage what kind of protections are needed. Potential arrangements should be measured against their ability to provide continued transparency over the price of default tariffs, and what impact they might have on consumer trust, as well as the principles set out in this CfE.

Generally, NEA expects that some degree of protections will continue to exist in the market. Current default tariff arrangements allow Ofgem to prevent price discrimination and loyalty penalties through setting caps. For Ofgem to fulfil its duty in protecting consumers, NEA considers it necessary that Ofgem continues to have responsibility for the regulation of default tariffs. It should not be left to the market. In particular, the ability to determine the level of non-wholesale costs suppliers can recover from consumers is an area where Ofgem should have power. Regardless of the default tariff type that suppliers offer in the future, it would be unfair for suppliers to be able to recover more costs from one cohort of consumers compared to another cohort.

Additionally, there is an existing static Time of Use tariff within the price cap for households with a multi-rate meter. In its current form, it does not fully pass through the benefits of wholesale costs during off-peak periods to households. Households also lack the necessary advice and tools to take advantage of off-peak periods. For instance, not all suppliers clearly display the periods during which off-peak periods begin and end. Meters record off-peak consumption according to the Time Pattern Regime (TPR), which is not always visible on consumer accounts or bills. Protections in the form of information that suppliers must provide to consumers, and the format they provide it in, are just as important as protections on the type of default tariffs that suppliers can offer.

Question 5 - Should there be different default arrangements for consumers identified as being vulnerable?

The prepayment cohort is most likely to be fuel-poor or to be struggling financially, so it is sensible to consider whether different rules for default tariffs should be in place.[11] However, like all payment method cohorts, prepayment households differ in their ability and desire to

engage with dynamic pricing arrangements. Regardless of payment type, default tariffs need to be appropriate for vulnerable households.

It is also worth considering that new rules around the appropriateness of a prepayment meter mean that many households with significant vulnerabilities should no longer have a prepayment meter installed.[12] It is important to ensure that those new arrangements are properly enforced, since those rules will limit the risks associated with default tariff reform specific to prepayment households.

Question 6 - What rights should domestic consumers have over the type of tariff they default onto? Should all suppliers be able to provide both single- and Time of Use default tariffs for households to move onto?

It is important to ensure that consumers are not forced to adopt tariff arrangements that do not work for them. In the eventuality that suppliers offer both single-rate and Time of Use default tariffs, communication on the benefits and risks between the options will be critical for ensuring that consumers can make informed choices.

Question 11 - Are there any other technologies, for example storage heating, which you believe should influence the default tariff arrangements of the households?

If it is deemed appropriate for households with an electric vehicle to have separate default tariff arrangements, it is probable that those arrangements would also favour households with storage heating. There are around 1.4 million households that use storage heating in Great Britain. Many Time of Use tariffs designed for electric vehicle owners exclude those with storage heating, despite the cost savings and security of supply benefits that better access to these tariffs could provide. Households with storage heating are more likely to continue to rely on default tariff arrangements.

NEA shares concerns with other organisations about how households with a multi-rate meter for electricity are treated. Existing default tariff arrangements do not work particularly well for these households, especially because of the absence of advice and tools available for households with a multi-rate meter. Around 3 million households are on these multi-rate arrangements, such as Economy 7 or Economy 10, where they pay a cheaper rate for their night usage and more for usage during the day. NEA is concerned that these households are not seeing the full benefit of lower wholesale electricity costs at night and face a lottery in terms of what they pay with significant variations in Economy 7 tariffs depending on supplier, region and payment method. There is an opportunity in default tariff reform to improve tariff offerings for these households.

Question 15 - Should the current default tariff cap be either reformed or replaced with more flexible price regulations as we transition to MHHS? If so, when in the transition to MHHS do you believe that change should take place?

While it's important to pass through the cost savings of a renewables-based system, it is also important to deeply consider the impact that changes to default tariffs will have on households who are already facing affordability pressures. Reforms to the cap, or the introduction of more flexible price regulations should not be brought forward too quickly. MHHS will allow suppliers to pass through benefits to consumers through existing or new smart tariffs. For default tariffs, it is not clear to NEA that there would be a benefit in reforming default tariff arrangements or arranging new ones. Any such change would need to come with a clear benefits case, and a distributional analysis of how vulnerable and low-income households would be impacted.

Question 16 - Do default price regulations need to support a greater diversity of tariff types to help secure lower long-term bills and meet households' different energy needs? If so, how might this best be achieved?

In some cases, a diversity of tariff types will help to secure lower long-term bills and meet different energy needs. For example, most prepayment households would benefit from a default tariff which reallocates costs to the unit rate to allow for lower standing charges. Allowing for diversity in default tariff arrangements must not create unnecessary complexity for consumers. As noted above, the price cap has allowed for transparency and trust among consumers and stakeholders. Options for reform should maintain transparency in how default tariffs are priced.

Question 17 - If price protections for default electricity tariffs are reformed in future, do you believe that regulations for default gas tariffs should also be updated?

No, the benefit of default tariff reform for gas tariffs is unclear. The price cap in its current form allows for transparency over costs and is highly supported by the public. Additionally, the price cap has served to protect consumers from volatility in gas costs over the past few years.

References and Notes

[1] For more information visit: www.nea.org.uk.

[2] NEA also work alongside our sister charity Energy Action Scotland (EAS) to ensure we collectively have a UK wider reach.

[3] Public First (2024) Fuelling Fairness: Five years of the energy price cap
[4] Carbon Brief (2022) Cutting the 'green crap' has added £2.5bn to UK energy bills
[5] Maxine Frerk (2020) Electric storage heating – a Cinderella solution
[6] Ofgem (2024) see 'costs included in the price cap level' for different payment types on the Retail Market Indicators page
[7] Ofgem (2024) Decision on adjusting standing charges for prepayment customers
[8] Public First (2024) Fuelling Fairness: Five years of the energy price cap
[9] Public First (2024) Fuelling Fairness: Five years of the energy price cap
[10] Carbon Brief (2022) Cutting the 'green crap' has added £2.5bn to UK energy bills
[11] CMA (2016) CMA Energy Market Investigation Appendix 9.9 – Prepayment
[12] Ofgem (2023) Involuntary PPM decision