

Darren Jones MP
Chair, Business, Energy and Industrial
Strategy Committee

BY EMAIL ONLY

Date: 21 February 2022

Dear Mr Jones,

Thank you for the opportunity to provide evidence as part of your Committee's inquiry into energy pricing and the future of the energy market.

Following the oral evidence session, there were a number of areas where I wanted to write to the Committee with further information. I have set these out in turn below:

Auto-switching

While Ofgem itself does not collect specific data on auto-switching, the latest available industry data suggests that approximately 2% of switchers in the domestic energy market used an auto-switching service¹. Overall, therefore, we believe that auto-switching services have had a relatively limited impact on the overall market, including in relation to the supplier failures that we experienced over the autumn and winter.

Operationally, there is a risk that if a supplier – particularly a small supplier – takes on a very large number of new customers unexpectedly, whether via an auto-switching service or some other means, they may not have either the operational or financial capacity to serve those customers well. While this was not a material factor in the recent supplier failures, in a small number of cases before this, we did see suppliers who had acquired large volumes of new customers quickly, encountering difficulties afterwards – for example with maintaining high levels of customer service.

While Ofgem does not have any direct regulatory powers in respect of switching services, the package of measures we announced in December 2021 will strengthen the financial and operational resilience of suppliers. One of the measures we are consulting on, for example, is a requirement on suppliers to pause expansion until Ofgem is satisfied that they are financially resilient before they grow beyond certain milestones such as 50,000 and 200,000 customers.

Restricted meters and the price cap

The price cap is not a limit on customers' total bills – which will vary according to their consumption – but is rather a limit on the standing charge and price for each unit of electricity and gas (that the bill is then calculated from).

The exact level of the limit on these standing charges and prices for units of energy varies according to where a customer lives, how they pay, and their type of energy meter. This reflects the different costs to serve customers according to these factors.

¹ September 2019.

There are, therefore, differences in the level of the price cap between different areas. This reflects differences in network costs – with the price that consumers pay reflecting how much it costs to transport energy to where they live.

Generally speaking, electricity distribution charges are higher than average in North Scotland, Merseyside & North Wales and the south-west of England and lower in London and Eastern England. In contrast, electricity and gas transmission charges are higher in the south of England and lower in Scotland, while gas distribution charges are higher in London and the south of England and lower in Scotland and the north-east of England.

Consumers with restricted meters are charged electricity at different rates depending on the time of day that energy is being used (e.g. a cheaper rate that applies for consumption during the night and a higher rate during the day). Restricted meters are often linked to electric heating systems, which allows that system to take advantage of times when rates are lower.

The price cap does apply to all suppliers' default tariffs, including those on restricted meters such as Economy 7 and Economy 10. This means that while suppliers can vary the rates set at different times of day, the average rate cannot exceed the level of the price cap for customers on restricted meters.

More generally, we know that many customers on restricted meters have struggled with accessing and assessing information about tariffs available to them, which in turn has made it difficult for them to switch tariffs. In recent years, a number of measures have been introduced to provide more information and choice to customers on restricted meters. This includes an obligation to offer certain single rate tariffs to customers with restricted meters – which, in some cases, may be cheaper for customers.

In addition, Ofgem has also taken action in a number of cases where we have found that suppliers have broken the rules for customers on restricted meters – including, for example, in cases where customers have been incorrectly charged. This has resulted in compensation to affected customers and goodwill payments.

Planning and modelling

Ofgem has developed a series of scenarios to understand how a range of factors could affect wholesale gas prices and, in turn, energy prices for consumers. This is part of broader work we do with Government and the system operators to ensure gas and electricity security of supply.

The Committee asked, in particular, about the effect of the situation in Ukraine on consumers energy prices. The vast majority of the UK's gas supply comes from the UK Continental Shelf, Norway, shipments of liquefied natural gas (LNG), and interconnectors with Belgium and the Netherlands. Only a very small proportion is sourced from Russia – in 2020 (the latest year for which data is available), less than 3% of our gas was sourced from Russia.

However, the GB market is closely connected to markets in Europe, and prices are highly correlated, so a price rise in other countries, which are more dependent on supplies of gas in Russia, in turn is likely to result in an increase in gas prices in GB too.

This means that flows of gas from Russia are one variable that can impact upon wholesale gas prices and, in turn, the prices that consumers pay, but the extent of the impact depends on other factors including LNG shipments, market sentiment, storage levels, and weather forecasts.

In these different scenarios, wholesale gas prices can range from levels of around 45 pence/therm to as much as 450 pence/therm. We continue to monitor these scenarios, and what drives them, very closely to be able to assess risks to consumers from both a price and security of supply perspective.

Credit balances

We discussed the cost of recent supplier failures, and in particular, the cost of protecting consumer credit balances. I explained that while, at the moment, only approximately 3.6% of levy claims from suppliers who had taken on customers through the Supplier of Last Resort process related to the cost of protecting consumer credit balances, this could increase to approximately 10% of the total claims made. In the meeting it was put to me that this would amount to roughly £200m. We would like to provide a more detailed estimate on levy costs and their breakdown, in the further written evidence we intend to submit. In addition, the final costs will, of course, be published by Ofgem.

I hope this information will be helpful to the Committee.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'JBearley', written in a cursive style.

Jonathan Brearley
Chief Executive