

## Written evidence submitted by Octopus Energy (ENB0038)

Octopus Energy is a licenced energy retailer (now the country's largest domestic electricity supplier and second biggest gas supplier). Through our sister companies we are also a key provider of energy services, manufacturing and installing heat pumps alongside solar panels, EV chargers and domestic storage into thousands of homes; and a major generation developer, managing c£8bn of assets much of which is deployed into renewable generation and storage in Britain. More details about the Octopus Energy Group can be found [here](#).

We support the committee's enquiry into the important topic of energy affordability. More households than ever<sup>1</sup> are struggling to pay their energy bills. While the net zero energy system promises cheaper as well as greener power and much lower energy costs for all, we must tackle today's pressing affordability issues and strive for a fair transition. If we don't succeed, concerns about affordability and fairness will threaten to hold up or even stop progress to net zero.

Our key points to the Committee can be summarised as:

1. Above all, there is an urgent requirement for tax-payer funded energy bill support targeted at the lowest income households in the worst insulated homes. We see this as an essential complement, not substitute, for ongoing price cap protection so everyone pays fair prices, whether they engage in the market or not. We do not support a rising block tariff or other measures which create a "cliff edge" of customer eligibility for lower energy prices as this will create new categories of homes that struggle to pay their bill. If taxpayer funds are not available, Government could help suppliers allocate their own customer support sums (in our case over £30m) by allowing suppliers to have access to customer benefit data.
2. We agree that the uplift in the price cap for customers that pay by standard credit or through prepayment meters is currently too high. However, we do not support measures to artificially reallocate the costs that suppliers have incurred in buying

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<sup>1</sup>6.5m households in fuel poverty this winter according to recent research by [NEA](#)

and delivering energy to their customers as this will distort the market and delay much needed innovation. Instead of “tweaking” the price cap, we would far prefer Ofgem to take a “root and branch” review of whether the key system and supplier own costs that make up the bill are properly allocated to fixed/meter related charges (which end up in the standing charge) vs unit rates and properly allocated across different payment types.

3. In addition, in the interest of affordability, it is vital that Ofgem and Government do all they can to keep the overall cost of the energy system down, relieving customers of the burden of paying inefficient and unnecessary costs as we transition to net zero. There is more that could be done here.
4. Smart Prepayment meters offer valuable budgeting and other support to lower income households and are cheaper to service than their traditional meter alternatives. They need to be rolled out as fast as possible. We would welcome the Committee championing this cause. We would also like to see Ofgem be more proactive in driving suppliers to support their customers in getting off standard credit payment arrangements which are a poor budgeting tool especially when combined with only quarterly billing.
5. Separately, as a last resort solution where customers in persistent debt refuse to engage, smart prepay meters can be installed under warrant to help to minimise bad debt (which all customers ultimately have to pay for). Although we currently have no plans to install under warrant, should we decide to do so, Ofgem have developed robust regulation and monitoring to ensure best practice around involuntary prepayment meter installs.
6. Finally, our Fan Club arrangements illustrate how people close to wind turbines can save money from low cost green power, while turning NIMBYs into YIMBYs. However, these arrangements are the exception, not the rule across the land. We are missing a significant opportunity to use market reforms &/or planning arrangements to provide tangible benefit for those close to the new infrastructure needed to reach net zero. Learnings from Fan Club can be applied to development of network infrastructure.

## 1. What are the justifications for allowing or removing standing charges from energy bills?

Standing charges are at a historical high, driven by changes to the way system costs are incurred and inefficiencies throughout the system. This is not fair, low income and prepay households are less able to afford this unavoidable and unmanageable cost to access energy.

The most logical way to charge a customer is for the supplier to pass through costs as they incur them. The price cap itself is set in this way (with fixed, meter or customer related charges making up the standing charge, and all volumetric charges and costs recovered in the unit rate). This approach ensures that high energy users are not unwittingly subsidising lower energy users and vacant properties. Instead of artificially redistributing these fixed costs in order to reduce the standing charge, Ofgem's focus should be on reducing costs - through driving efficiencies across the system (network, balancing, expediting removal of legacy systems, levies and supplier costs) and making sure that network and other charging methodologies properly and fairly distinguish between customer/meter related costs and those driven by the number of units consumed. We have recently submitted our thoughts to Ofgem on this, to be published in due course<sup>2</sup>.

We are concerned that Ofgem is increasingly attempting to use the price cap to address affordability issues through shifting suppliers' fixed/customer related costs onto unit rates and then introducing complex redistribution mechanisms. These risk distorting the market, worsening rationing amongst customers with high energy needs, and diminishing supplier incentives to innovate.

Instead Ofgem, along with Government, can reduce the standing charges customers face by keeping whole system costs down. We suggest this can be achieved by:

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<sup>2</sup> Likely to be published [here](#) in the interim we have sent a copy separately to Select Committee

1. Considering how to optimise upstream costs (network, balancing and optimisation of generation and storage assets), including through tighter efficiency incentives in the network price controls and wholesale market reform
2. Considering whether system costs are fairly allocated between fixed and variable charges (eg through the various network charging methodologies) and that agreed methodologies are properly implemented
3. More generally, making sure that the distributional implications of changes to regulations elsewhere - for example the Transmission Charging Review (TCR) - on the prices customers face are better understood before making decisions, and as part of these decisions considering the opportunity to structure charges to assist with distributional concerns
4. Conducting a thorough supplier opex review, including reassessing the cost reflective split between customer related and unit driven opex and whether cost uplifts for payment methods truly reflect the cost to serve those customers
5. Encouraging innovation and the use of flexible solutions to drive down sunk costs - eradicating inefficient energy waste<sup>3</sup> and helping customers to shift necessary energy<sup>4</sup> usage into cheaper (or even free)<sup>5</sup> time periods, without needing to ration energy
6. Working with government to reduce regressive levies and taxes on the bill
7. Focussing incentives and support to improve housing stock noting “two-thirds of people did nothing to improve the energy efficiency of their homes in 2023, due to upfront costs”<sup>6</sup>

## **2. Should companies be allowed to provide cheaper bills to those who choose to pay by direct debit?**

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<sup>3</sup> [Energy Saving tips](#)

<sup>4</sup> [Price cap protect: Octopus' customers beating the price cap by reducing energy usage](#)

<sup>5</sup> [Power Ups](#)

<sup>6</sup> [EUK](#) and One Home commissioned Public First research Jan 2024

Yes, compared to Direct Debit, it costs slightly more to serve customers that pay through Standard Credit methods. Charging a modest uplift is both justified and can help incentivise customers onto more efficient payment methods.

However, we are very concerned that the current uplift for Standard Credit customers in the price cap far exceeds the additional cost to serve. We do not charge the full uplift - currently £130 - to our Standard Credit customers, we pass on £80, a value we consider reflective of the additional cost to serve.

Further, research in 2022 suggests that 75% of customers who pay by cheque, cash or card think they pay the same or less than someone paying by direct debit - suggestive that suppliers need to communicate more effectively with their standard credit customers about the extra cost they are paying<sup>7</sup>. We would like to see Ofgem do more to urge suppliers to encourage customers off standard credit payment arrangements. These do not assist with affordability especially, as is still the case, when combined with quarterly billing. On current prices this means a typical customer could be paying close to £700 to cover the cost of their winter energy use<sup>8</sup>.

In the case of prepay customers, the high cost of traditional prepay metering has historically provided some justification for a higher tariff. However, as smart prepay metering is installed, this very substantially reduces (and will eventually eradicate) the additional cost to serve prepay customers. We continue to call for a rapid removal of legacy prepay meters. Even ahead of the EPG arrangements, we removed the cap uplift for our smart PPM customers, and consider it is vital to make sure these customers, who are often repaying a debt and still struggling to pay, do not incur unfair unjustified energy costs.

While we support Ofgem's ambition to levelise prepay and Direct Debit prices, we would much prefer to see Ofgem revise the prepay price cap to reflect the lower cost

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<sup>7</sup> [Octopus Energy](#) calls on Ofgem to clamp down on payment penalty for careful customers

<sup>8</sup> Calculation: Average unit rate for a single rate dual fuel household x profile curve usage Jan-Mar for TCDV usage + standing charges, includes VAT

of smart prepay metering, which we expect would result in a very substantial reduction (and eventual eradication) in the uplift needed for prepayment customers. In current design Ofgem is instead proposing to lock in inflated price cap cost allowances and asking all direct debit customers to pay for this, many of whom are already struggling to pay. Ofgem is also missing an opportunity to incentivise suppliers to take out harmful traditional prepay metering through setting an uplift that tapers off according to the desired switch out of traditional for smart prepay meters.

**3. Are pre-payment tariffs necessary to deter fraud and theft and, if so, are the rules in forcibly switching people to pre-payment properly policed?**

The cost of energy continues to be significantly high and many households are struggling with negative monthly budgets. Suppliers must ensure they do all they can to prevent customers from falling into debt in the first place and that debt journeys are effective in helping customers get out of debt quickly. This means enabling a customer to set up flexible payment plans, take breathing space and always be served with trust, empathy and respect.

Whilst we have strongly advocated for the eradication of traditional prepayment meters we do continue to believe that providing a smart prepay meter is beneficial to customers, unlocking the ability to budget effectively and avoiding bill shock at the end of the month. Smart prepay is designed with real-time protections built in, allowing our highly trained Energy Specialists to monitor for any self disconnection and provide immediate support, for example in the form of standing charge holidays and emergency top up. Beyond that, Smart prepay is our cheapest standard tariff and well below the price cap - making it both a useful tool and an affordable one.

Unfortunately, there are customers who are capable of paying their energy bills but who refuse to do so, increasing costs for everyone - including those who are doing without essentials to meet their monthly payments. Using smart prepay as a tool to stop this cycle, through an involuntary install and only as a last resort, minimises the burden on other households.

Ofgem's new rules mean that before a supplier seeks permission to install a PPM under warrant, there will have been extensive attempts to communicate with the household, and offer help with budgeting and debt repayment. Often a customer will only begin to engage with their supplier when they have received a letter informing them that the warrant process has started, and engagement will then immediately halt the warrant. For this reason alone, the ability of suppliers to install under warrant is a valuable option.

Ofgem has extensively revised and strengthened the rules relating to forcible installation to ensure that if a household does reach the stage where an involuntary installation takes place (which would only be as a last resort) the supplier will have robust, Ofgem approved, processes in place. In particular, this prohibits the install under warrant for certain categories of customers for whom this would be harmful. We fully expect Ofgem to thoroughly monitor adherence with the new rules and to take swift action if there are any concerns. There is a high degree of media attention on this practice, providing additional scrutiny. All suppliers are also required to have their own internal and independent assessment panels reviewing each case ahead of installing under warrant.

Octopus has been given permission by Ofgem to commence installing prepay under warrant but we currently have no intention to re-start this activity. In our entire history we have only ever installed 32 meters through this route and have always seen this measure as a very very very last resort measure.

**4. Should there be greater use of discounts on energy for those who live closer to energy infrastructure?**

With a single wholesale price across Britain there are no energy cost benefits to customers living close to renewables. This issue could be resolved holistically through the creation of locational wholesale markets which better reflect local demand supply balances across the country. This would bring down the wholesale price of electricity

for parts of the country where there is an abundance of renewable power. Also, as work commissioned by Ofgem has shown, it would reduce the overall cost of the system (for example, by removing the need to pay windfarms to be constrained off), meaning the customers everywhere would face lower prices. Ofgem estimates customer savings of between £28bn and £51bn under a nodal pricing regime over a 15 year period to 2040 but this could be significantly more when the impact of attracting new investment to areas with low prices, and the ability to reduce expenditure on new networks is taken into account.

Ahead of these market reforms, [Fan Club](#) has demonstrated that you can turn NIMBYs to YIMBYs simply by passing the value of low priced wind to local customers when the local turbine is blowing. With 20k communities now asking us for local turbines and demonstrating that consumer behaviour and attitudes should not be assumed as set in stone. We think there are principles in the Fan Club approach which could be used in the development of new transmission infrastructure.

**5. Is it right to expect those in more remote areas of the country to pay higher amounts in standing charges?**

Remote, rural areas often face the highest energy bills as low density and other factors drive high network charges. There is opportunity to review how these charges are incurred, although we recognise this will not be a quick fix. As per our response to Ofgem's standing charge call for input we consider this question of whether to "socialise" network costs to be one for Government or Ofgem.

Ofgem sets allowed revenues for each regional network company and areas of low population density will have higher unit rates and standing charges than in more urban areas. In line with our response to Question 1 above, Ofgem should not try to sort the issue out by "tinkering" with the retail price cap when suppliers have already incurred network charges which differ across the country. Rather they could create a postalised network charge - through reconciliation across network companies - if they wanted to reduce or end regional differences in consumer prices.



Older rural houses are typically the most leaky and therefore these customers already face far higher energy bills. The Government can drive beneficial change, reducing energy bills through a continued commitment to home upgrade incentives and obligations - with more focus on social housing and rental properties.

## **6. How should a social tariff be implemented to address inequalities in billing?**

The cost of energy (both the standing charges and the unit rates) is currently far higher than pre crisis and many households simply cannot afford their energy bills. This translates to customers who go into long term debt - Ofgem stating that there is currently c£3bn in energy debt greater than 90 days<sup>9</sup> - as well those rationing basic household needs (food, energy, health + hygiene) and an explosion in mental health difficulties. We have seen this through our own customers and have invested heavily in being able to support them as best we can - refer to written evidence Annex A provided to the Inquiry into Preparing for the winter<sup>10</sup> for more information, noting we have since doubled financial support to £30m. We flag to the Committee that our ability to support our customers could be significantly enhanced if there were data sharing arrangements in place to help us understand which of our customers are in receipt of benefits.

However, as Citizens Advice demonstrates, the emergency tools that energy suppliers provide are not able to address the root cause of affordability (nor should they be), with millions of households consistently in budget deficit<sup>11</sup>.

We are concerned that there is a continual focus on “social tariffs” as the answer to this predicament - with the implication that other customers can subsidise the cost for those who struggle to pay their energy bills. Far better is to keep the Government held to account for social welfare, to which we recognise progress has been made

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<sup>9</sup> [Ofgem debt and arrears indicator](#)

<sup>10</sup> [Supplementary written evidence submitted by Octopus Energy \(WIN0059\)](#)

<sup>11</sup> [Citizens Advice cost of living dashboard](#)

through the autumn statement in 2023, and to provide targeted energy bill support to those in leaky homes and most in need. We repeat messages that we have given before that there is an urgent need for this taxpayer funded support.

One approach might involve using taxpayer funds (instead of customer standing charges) to implement an improved, expanded Warm Home Discount scheme. Targeted winter support through the Warm Home Discount already supports households with both peak heating costs and home upgrades but the funding is regressive and the design has not been able to react with agility to the cost of energy. There is scope to make improvements - removing the funding from energy standing charges and into general taxation, considering whether the breadth of support can incorporate cost of living payment recipients and pegging the depth of support to the price cap, akin to a targeted EPG.

There are three key benefits to WHD:

- a) WHD provides a cash payment onto energy bills enabling households to choose both their supplier and the tariffs and services of their choice. This ensures that households are not excluded from beneficial products and that innovation remains accessible and able to draw on feedback from all households.
- b) A focus on Industry Initiatives is helping to drive down future costs by improving the efficiency of households through appliance upgrades and retrofits. This year we are pleased to be able to provide Solar installations to qualifying households, helping them to significantly reduce their chargeable usage - they can access free energy whenever the sun shines. This approach complements the work of ECO and GBIS alongside financial support packages such as the Boiler Upgrade Scheme.
- c) WHD is a live “social tariff” with a strong framework in place. Rather than reinventing the wheel it would be easier to review WHD, ensuring that it continually improves as an interim tool to support households with low income and high energy costs.

We understand that the Select Committee has previously expressed an interest in whether rising block tariffs could solve the affordability problem. Whilst households can have the ambition to reduce their usage needs in order to stay within a certain block of usage they are constrained by their leaky homes and household needs. To attempt to reduce usage under such conditions will inevitably lead to unsafe rationing and/or escalating debt from lower income households in inefficient, leaky homes. Further the energy transition is already demonstrating that greener, cheaper energy can be unlocked through shifting when energy is used, not restricting how much energy is used. Support for rising block tariffs on the grounds of encouraging energy efficiency is significantly undermined and they would hinder the widespread roll out of smart, time of use tariffs.

With a longer term view, Government has an important role to play in ensuring there is a focussed investment in making greener cheaper choices - improving housing stock and making sure that lower income customers can afford heat pumps and other measures to help them save on their energy costs through reducing energy waste and optimising energy usage.

Finally, the price cap protects disengaged customers from unfair pricing practices, encourages suppliers to improve their efficiency and has recently enabled Government to swiftly deliver emergency support through the Energy Price Guarantee. A social tariff - or any other measure to address affordability - is a complement but not a substitute for the guarantee of fair prices for all customers. The price cap must stay in place and over time it can help ensure that the system cost reductions which can come about through running a smart, flexible system, are shared by all, not just those with electric heating and EVs.

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