

Citizens Advice Bureau- Written evidence (ONZ0012)

1. About Citizens Advice

- Citizens Advice gives people the knowledge and the confidence they need to find their way forward - whoever they are, and whatever their problem.
- Our network of independent charities offers confidential advice online, over the phone, and in person, for free.
- We are the statutory advocate for energy consumers and run the national consumer helpline. Last year we helped 2.7 million people with 6.3 million problems.
- We use our evidence to show how things can be improved for people.

2. Reason for submitting evidence

- Citizens Advice is the statutory consumer advocate for the electricity and gas sectors, designated in accordance with the Consumers, Estate Agents and Redress Act 2007. We work closely with Ofgem, while also providing independent scrutiny of its actions and activities. A key theme of our current workplan¹ is ensuring a cost effective transition to Net Zero that meets consumers needs.

3. Executive summary

3.1 The transition to net zero will involve significant disruption to existing market models and considerable change in consumers' lives.

3.2 Ofgem should work to ensure that consumers in vulnerable circumstances benefit from the transition, focusing innovation testing and support on those who might otherwise be left behind.

3.3. To ensure that its role is clear, the Government should consider using its existing powers to designate a Strategic Policy Statement for the energy sector, to clarify how it sees the division of roles and activities between Ofgem and Government.

¹ [The Citizens Advice consumer workplan 2021-22.](#) Citizens Advice, July 2021.

3.4 The Government should also introduce a framework for regulation for heat networks and for Third Party Intermediaries, to boost consumer confidence and protection in those sectors.

4. Submission

1. How well does Ofgem fulfil its obligations to consumers? Does Ofgem take consumer views into account sufficiently, particularly those of vulnerable consumers?

4.1 Ofgem takes account of consumer views in a wide range of ways, and in Citizens Advice's view has improved its understanding of consumers over time.

4.2 Ofgem conducts its own quantitative and qualitative research, and Citizens Advice regularly co-commission research with it in areas where we have a joint interest. It also draws on the insight of Citizens Advice and our research programme as the statutory consumer advocate, as well as with other charities and consumer groups, and engages with them regularly. Ofgem has trialled some policies directly, for example in relation to encouraging collective switching. It has also used some co-creation methods to develop policies with direct consumer input, for example in relation to the development of the energy price cap. In relation to networks, Ofgem has required companies to set up Consumer Engagement Groups to assess how well companies take account of views, and has also enabled direct innovation trials with consumers by networks.

4.3 All of these approaches are likely to be needed and expanded as policies are developed to meet Net Zero, and where Ofgem does not have powers to run or enable trials it should be enabled to do so. It will also be important that it builds its own data capabilities in order to ensure that it can understand market developments and deliver better consumer incomes.

4.4 Some consumers in vulnerable circumstances will need particular support in the transition to net zero, and customers in fuel poverty and on low incomes already face energy costs that they struggle to pay. These issues around affordability are primarily for government, which has proposed increases to social schemes like Warm Home Discount and the Energy Company Obligation.

4.5 Since 2019, default tariffs - those that a customer will be on if they have never switched or if the deal they switched to has expired - have been subject to a price cap. This limits how much they can be charged for each unit of electricity and gas that they use. Ofgem estimates that it saves eligible customers £75-100 per year. Customers could typically still save money by shopping around, as while the price cap is formulated to

reflect a fair price for electricity and gas it is not intended to be a 'Best Buy' and can always be beaten.

4.6 The price cap is time-limited by legislation, although BEIS has recently announced an intention to bring forward legislation to extend it. Citizens Advice supports that step. A former CEO of Ofgem has said that some disengaged vulnerable customers may never be able to fully participate in the market.² Given the long-standing problem of consumer disengagement in the sector, and the essential nature of energy, we think that some form of protection for consumers in vulnerable circumstances is likely to be needed even after the cap ends. This could take the form of a narrower price cap that focuses on consumers with vulnerable characteristics, a social tariff or some form of targeted support or rebate. Because either of the latter two options would involve subsidy, it is likely that they would need government intervention, or an amendment of Ofgem's powers and objectives, if they were to be taken forward.

4.7 Ofgem can more easily take action in relation to protecting people from poor practice by their supplier, or by putting in place rules that require them to be given more support. It recently strengthened its rules on debt and has put in place new protections for customers on prepayment meters to make it less likely that consumers in vulnerable circumstances will go off supply. Steps like these are vital to support people through the impacts of the pandemic, and will remain so throughout the transition to net zero to protect people who fall behind on their bills.

4.8 Ofgem can also take steps to help consumers in vulnerable circumstances benefit from new products and services, so they can benefit from the transition as much as other customers, while avoiding services that might put them at risk. It is currently consulting on how it supports innovation through support for start ups and a regulatory sandbox. We think this should be focused on supporting innovation specifically to benefit consumers in vulnerable circumstances, who may otherwise not be the target audience of innovation trials, where products can be tested safely.

4.9 Ofgem's rules already require that energy suppliers treat customers fairly, taking account of any vulnerabilities, and that all customers are only recommended products that meet their needs. Similar rules exist in financial services, but the FCA is currently consulting on strengthening these requirements such that companies have to actively deliver good outcomes for their customers, and must ensure that services meet their customers needs. This is at an early stage but Ofgem should monitor the impact of these changes, and consider whether similar changes could

² Paragraph 17, '[Pre-legislative scrutiny of the draft Gas and Electricity \(Tariff Cap\) Bill.](#)' BEIS Select Committee, February 2018.

ensure customers avoid being locked into energy products and services that don't meet their needs.

4.10 Ofgem decisions on reforms like network charging and half hourly settlement will impact how costs are distributed between customers, including those with more vulnerable characteristics. It is vital that there is a clear understanding of these impacts in order to decide how to proceed with changes, and to put in place appropriate mitigations. Ofgem has developed a new set of consumer archetypes to understand how people with different characteristics might be affected, which are helpful in understanding these impacts for individual policy reforms. However, it is still challenging to understand how different policies 'stack' on one another in terms of their impact on an energy bill, or more widely by decisions that are being taken across markets.

4.11 The government is due to publish a paper considering how regulators can share data to enable regulators to develop a 'whole customer view'.³ Regulators, including Ofgem, have also been challenged by the National Audit Office in the past to do more to define the outcomes they seek to achieve and do post-implementation monitoring of their policy decisions.⁴ However, impacts of these changes may be specific to when, where and how people are using energy, and so some qualitative understanding of how people may be affected, and ensuring good access to support and advice for all is also important.

4.12 Finally, an important function of the regulator is ensuring compliance with its rules and enforcement where companies fail to do so. This role has grown more challenging as the number of market participants has grown, with many new entrant suppliers poorly prepared for the market and subsequently failing. Over 20 suppliers have failed since 2018, and we estimate this has left mutualised and other costs of over £250m.⁵ At the same time, the move towards more principles-based regulation requires more two-way communication with companies to understand compliance issues when they arise and share learnings with the sector.

4.13 To tackle these risks, Ofgem has been conducting a supplier licensing review, which has given it more powers to ensure companies pass stricter entry tests, monitor company processes and financial stability, and intervene to restrict the growth of companies with unsustainable business plans.

4.14 In future, Ofgem will also need to manage the risks posed by innovative new products and services, which may pose new consumer

³ ['Response to the regulation study: strategic investment and public confidence.'](#) Treasury, November 2020.

⁴ ['Regulating to protect consumers: utilities, communications and financial services markets.'](#) March 2019.

⁵ ['Picking up the pieces - updated analysis.'](#) Citizens Advice, December 2019

risks and overlap different regulatory boundaries, as well as overseeing new markets if it takes on functions related to heat networks and TPIs.

4.15 In order to do this work effectively and maintain a credible deterrent, Ofgem needs to properly resource its compliance and enforcement functions, and use them effectively. In the recent past we've been concerned that its work in these areas has been too slow to tackle issues and taken too long to complete (with some cases taking up to 4 years), not been transparent enough, and not prioritised compliance with some areas of the rulebook with high consumer detriment, including to customers in vulnerable circumstances.⁶

2. What role should Ofgem play in the transition to net zero? What changes, if any, should be made to its remit, responsibilities and resources?

4.16 Ofgem has a crucial role to play in the transition to net zero. Beyond the decarbonisation of power itself, the sector will be needed to provide a platform for the decarbonisation of transport and heat. The decisions Ofgem makes have the potential to significantly help - or if made badly, impede - our transition to net zero, and to impact on the costs of that transition.

4.17 Ofgem already has some duties in relation to tackling climate change. For example, its principal objective to protect the interests of existing and future consumers is defined as including the interests of those consumers taken as a whole, including their interests in the reduction of greenhouse gases. In performing its duties, it is also obligated to have regard to their impact on the achievement on sustainable development.

4.18 In addition, the Energy Act 2013 provided powers for the Secretary of State to designate a Strategic Policy Statement (SPS) in which (s)he would set out the Government's strategic priorities and other main considerations of its energy policy, the policy outcomes to be achieved as a result of the implementation of that policy, and the roles and responsibilities of those who are involved in implementation of that policy. The Act imposed new duties on Ofgem to have regard to the strategic priorities when carrying out its regulatory functions and to carry out those functions in the way it considers is best calculated to further the delivery of the specified policy outcomes. Despite these powers existing, a

⁶ [Citizens Advice response to consultation on Ofgem's Enforcement Guidelines and Sectoral Penalty Statement](#), August 2020

Strategy and Policy Statement has yet to be put in place for energy and Ofgem.

4.19 It has been suggested that giving Ofgem a clearer statutory obligation to deliver net zero would be helpful in focusing its work on that aim. We are open-minded on this. We recognise that the weight of calls for this change suggests that there may be significant belief that greater clarity on that point may unlock investment, and help Ofgem to take a wider view of the impact of its decisions. At the same time, we are mindful that as a single sector regulator it may be very difficult for Ofgem to take a holistic view of its role in other parts of the economy. Given the various possible pathways to net zero, it may be that the introduction of a net zero duty does not result in greater clarity on its role (i.e. that dispute will remain on what such a duty commits it to in practice).

4.20 The introduction of an SPS could provide a means for the government to provide Ofgem with greater guidance on how it sees its role and how it should be acting on climate change.

3. Is Ofgem's current system of price controls appropriate? Does it provide sufficient incentives to invest in the context of the transition to net zero?

4.21 We believe the incentives provided by Ofgem's current system of price controls are more than sufficient to invest. This is clearly demonstrated by the price National Grid was willing to pay to acquire Western Power Distribution recently - a premium of 60% on top of the Regulatory Asset Value ('RAV'). SSE has just sold its minority stake in SGN for a premium of over 30% on top of its RAV.

4.22 The greater issue is that rewards for investing are too high. A wide consensus has developed that network companies have been able to make returns that are higher than necessary. The National Audit Office, UK Regulators Network, sector regulators, consumer advocates and energy retailers all appear to broadly agree that consumers have been overpaying for low-risk utility services. Typifying this view is the National Audit Office's observation that, 'Under Ofgem's current regulatory framework, electricity network companies have provided a good service, but it has cost consumers more than it should have.'⁷

4.23 We explored these issues of overpayment of networks over a number of years in a range of reports.⁸ We found that regulators have

⁷ 'Electricity networks,' NAO, January 2020.

consistently over-estimated the cost of borrowing and investment to network utilities. The costs of borrowing money and return needed for investment have been lower than they thought they would be.

4.24 If this perception of overpayment is not successfully addressed, we believe that the legitimacy of price controls may be challenged. This, in turn, risks the consumer trust and positive engagement required to deliver net zero.

4.25 The CMA has provisionally confirmed a lower cost of capital from the latest round of price control settlement, which is under appeal. Overall this is good news, but the appeals process requires reform. Current arrangements allow network companies to 'cherry-pick' the issues to be reviewed by the CMA, meaning the overall settlement is likely to be skewed in the favour of network companies. Learnings and best practice across regulated sectors should be identified and applied in energy.

4.26 Uncertainty, especially with regards to investment required to accommodate the electrification of heat and transport, creates challenges for the next electricity distribution price control, RIIO-ED2, which starts in April 2023. We welcome Ofgem's commitment to using flexibility technologies to reduce the expenditure required for network upgrades. Nevertheless, Ofgem will need to design mechanisms that allow the price control to adjust to changing demands.

4. Is Ofgem's relationship to Government and Parliament appropriate? Are there issues related to the split of responsibilities, transparency or accountability

4.27 Ofgem has no tax-and-spend powers, which is appropriate given that it is an unelected body, but limits its ability to support consumers in vulnerable circumstances. For example, when it comes to helping consumers reduce their energy bills it has significant control over policies to help them switch energy supplier or tariff, but very little control over improving energy efficiency or building fabric.

4.28 It may also be uncomfortable or slow to act where interventions are seen as controversial or legally fraught. An example of this is the introduction of the energy price cap, where some stakeholders were of the view that Ofgem could have implemented this remedy without legislation, but it was reluctant to do so citing a concern that it would result in legal challenges.

4.29 In its pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Act, the BEIS select committee noted that 'The

⁸ ['Many happy returns.'](#) May 2015. ['Energy consumers' missing billions.'](#) July 2017. ['Monopoly money.'](#) May 2019.

Secretary of State was clear that this Bill could have been avoided and customers could have received help more quickly if Ofgem had made use of its existing powers[...] We were unconvinced by Ofgem's argument that primary legislation was required for them to set a market-wide cap. We concur with the Secretary of State that legal challenges can be won and should not be a deterrent from implementing policies that are in line with the regulator's statutory duties to protect the interests of consumers.⁹

4.30 Given the much higher barriers to passing new legislation compared to altering energy licences, it will be important that Ofgem is quick to act, and culturally willing to take difficult decisions rather than deferring them to Parliament, as we transition to net zero.

4.31 Ofgem's remit is narrower than the range of actors that are expected to take part in the net zero transition. We think it should be extended to heat networks and to third-party intermediaries ('TPIs') given their significant current and expanding future role in the market.¹⁰

4.32 Our research shows that heat suppliers are not meeting some basic requirements to protect or support consumers on heat networks.¹¹ Ofgem should regulate heat networks. In the interim, it should look to help support better consumer outcomes through working with BEIS, the Heat Trust, the Energy Ombudsman and Citizens Advice.

4.33 Third Party Intermediaries (TPIs) play a key role in energy, acting to simplify a complex market and increase engagement. They range from helping consumers choose an energy supplier to making decisions on a consumer's behalf, like selecting their supplier for them. In future, aggregators (a form of TPI) may also directly control some energy usage, in response to price signals. Despite this important role, there is no direct regulatory oversight of TPIs, and consumers can struggle to resolve problems when they arise. We see cases where TPIs are not transparent about their service, where consumers are switched to inappropriate products and where they miss out on protections, with very little recourse.

4.34 We expect TPIs to become more prevalent in the coming years, playing an increasingly sophisticated role in delivering a net zero energy system. Poor practice by some will undermine consumer trust, while a lack of regulation may allow energy suppliers to lock innovative TPIs out of the market. The next government energy bill should bring forward a proportionate and flexible regulatory approach for TPIs. This would enable positive innovation for consumers, alongside support and access to

⁹ ['Pre-legislative scrutiny of the draft Gas and Electricity \(Tariff Cap\) Bill.'](#) BEIS Select Committee, February 2018.

¹⁰ ['Stuck in the middle'](#) Citizens Advice, March 2020

¹¹ ['Bringing heat networks up to standard.'](#) Citizens Advice, January 2021.

redress when things go wrong. This view was recently endorsed by the Prime Minister's Taskforce on Innovation, Growth and Regulatory Reform.¹²

4.35 As well as covering its own remit, Ofgem is likely to need to develop closer working relationships with other regulators in order to manage issues that cross regulatory boundaries. For example, the digitalisation of the energy sector, including much more granular data on personal energy usage via smart metering, means that data privacy will become increasingly important with associated input from the Information Commissioner's Office. Products and services which link energy services with technologies like batteries or heat pumps are likely to entail some sort of financing agreement, and may be in the scope of FCA regulation.

4.36 The National Infrastructure Commission regulation study in 2019 recommended enhancements to the UK Regulators Network to improve collaboration between regulators. In its response to the study the government also committed to publish a policy paper in 2021 looking at whether a cross-sector strategic policy statement could also enable this outcome, and how to improve data sharing between regulators.

5. Recommendations

5.1 Ofgem should target its work in supporting innovation specifically to benefit consumers in vulnerable circumstances, who may otherwise not be the target audience of innovation trials, where products can be tested safely.

5.2 The Government should consider using its existing powers to designate a Strategic Policy Statement for the energy sector in order to provide guidance to Ofgem on its expectations for the regulator, and to clarify how it sees the division of roles and activities between Ofgem and Government.

5.3 The Government should swiftly introduce a framework for regulation for heat networks and for Third Party Intermediaries, to boost consumer confidence and protection in those sectors.

20 August 2021

¹² [Taskforce on Innovation, Growth and Regulatory Reform independent report](#), June 2021