Written evidence submitted by Age UK (EPM0009)

Age UK Call for Evidence Response

Energy pricing and the future of the Energy Market

Department for Business, Energy, and Industrial Strategy (BEIS)

January 2022

About Age UK
Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe, and secure at home; and feel valued and able to participate.

Summary

Age UK has gathered a range of evidence on the impact of the energy crisis on older people and the energy market. This response to the Business, Energy and Industrial Strategy (BEIS) Committee inquiry into ‘Energy pricing and the future of the Energy Market’ outlines our views on the regulatory framework, Ofgem’s performance as regulator, the Energy Price Cap, and wider features of the energy market as listed in the call for evidence[1]. Our submission and recommendations are designed to help improve fairness in the energy market for older consumers.

Key points and recommendations

- The Energy Crisis has already had a devastating impact on low-income and fuel poor older households, and we expect its impact to be felt well into 2023.
- Older consumers are increasingly nervous about price increases, with our analysis showing that over a quarter of older households will be expected to spend 10% of their post-tax income on energy from April.
- The Government must step in and provide a one off £500 payment to all those eligible for Cold Weather Payment and a VAT exemption on household energy bills.
- Unexpected increases in wholesale energy prices were exacerbated by ineffective regulation, inadequate enforcement, and inappropriate standards for market entry.
- If better enforcement of existing rules, improved regulation, and higher standards thresholds for market entry are sufficient to avert future crises then we question the need for multiple complex Energy Price Cap reforms.
- We strongly recommend that any Price Cap reform avoids passing additional cost onto consumers during the winter months. Age UK disagrees with Ofgem’s proposal for quarterly Price Cap changes and proposes a compromise solution where the Cap changes three times a year - avoiding any increases from mid-November to mid-March. This would reduce the risk of older consumers self-rationing their energy use during colder periods.
- We also recommend that the Energy Retail Market Strategy is rewritten to reflect changes in the market and the reduced short-term viability of supplier switching as a mechanism for keeping down consumer bills.
- Age UK recommends that the recovery of funds associated with 2021/2022 supplier failures should be stretched out across several years instead of collected in the next Price Cap window between April to October.
- We reinforce the need for the Government to set a higher ambition for energy efficiency funding if it is to achieve a fair transition to net-zero for older people struggling on a low fixed income.
- The Government must consult on the reintroduction of improved social tariffs and legislate for the extension of the Price Cap beyond 2023.

Introduction

Age UK welcomes the opportunity to respond to this Business, Energy and Industrial Strategy (BEIS) Committee inquiry into 'Energy pricing and the future of the Energy Market'. Increased wholesale energy prices and supplier failures have resulted in an energy crisis affecting all households across the UK. Age UK has already seen a substantial increase in the level of enquiries to our Advice Line relating to energy bills, suppliers, and energy prices since October 2021. The crisis has worsened in 2022 and we anticipate it continuing to impact consumers well into the next year. In response, we launched our 'The Cost of Cold' campaign to highlight the difficulties older people face in the energy market and push for greater financial support[2]. We are calling for a one off £500 payment to all those eligible for Cold Weather Payment and a VAT exemption on household energy bills.

Age UK is concerned about increasing anxiety amongst older people about their energy bills. In December 2021, 43 per cent of over 65s were worried about heating their homes over the winter[3]. By January this year, more than three in five (62 per cent) of over-65s – 7.8 million people – were worried about heating their homes come the spring[4]. 82 per cent of over 65s think the Government should step in to help poorer older people pay their energy bills[5].

By the Government's definition there are already around 1 million older households in fuel poverty in England[6]. But far more are expected to struggle with their energy costs come April. Age UK analysis[7] showed that before the pandemic, around 1 in 10 older households were experiencing fuel stress[8], spending over 10% of their post-tax income on energy bills. If energy prices increase by 50%[9] from April this year, we expect to see this rise towards over a quarter (27%) of older households[10]. This represents 3.8 million people living in older households who will be stretching an already limited budget. The result will be an increasing number struggling to heat and power their homes.

Age UK also produced the 'Cost of Cold' report in December 2021. The report explored the impact of energy bill increases on older consumers[11]. The research highlighted the stories of older people fearful they would be unable to heat their homes sufficiently. Many expressed concerns about the knock-on impact of living in a cold home on their health and were worried that higher energy costs would reduce their ability to pay for other household essentials, such as food[12]. Older people have higher heating costs[13], spend longer at home, and have a greater propensity to live with health conditions which require more heating or energy use[14]. The energy crisis has already disproportionately impacted them and will continue to do so.

Our response to this call for evidence reflects our view that the present regulatory framework has failed older consumers and must be reformed. This should include a full independent review into what role regulatory failure played in catalysing the Energy Crisis. We also recommend that the Energy Retail Market Strategy is rewritten to reflect changes in the market and the reduced short-term viability of supplier switching as a mechanism for keeping down consumer bills.

Part of revising the Energy Retail Market Strategy must include a commitment from the Government to improve consumer support and protections. This must include direct payments to low-income consumers to mitigate expected energy price increases and a VAT cut on household energy bills. The Government have argued that existing social protections are sufficient to support people through the energy crisis. With around 3.2 million English households already in fuel poverty[15] before the energy crisis began and bills expected to continue rising rapidly throughout 2022, it is clear existing support falls far below what is required.

The Government must also legislate for the extension of the Price Cap beyond 2023 and consult on the reintroduction of improved social tariffs into the energy market. To provide a comprehensive Energy Retail Market Strategy for older consumers, the Government must include a commitment to ensure the nearly 1 million older people missing out on their Pension Credit[16] receive their full entitlement. Not only will this provide crucial income support for some of the most vulnerable older people in the energy market but it will also improve access to the Energy Company Obligation (ECO), Warm Home Discount (WHD), and Cold Weather Payment (CWP) schemes.

Our response below outlines our views on the energy market regulatory framework, Ofgem's performance as the regulator, the Energy Price Cap, and wider features of the energy market. Our response is structured around each of the statements put forward by BEIS in the original call for evidence[17].

The regulatory requirements companies must meet in order to trade as a regulated entity in the retail energy market.

Inadequate regulatory oversight played a major role in catalysing the Energy Crisis. Unexpected increases in wholesale energy prices were exacerbated by ineffective regulation, inadequate enforcement, and inappropriate standards for market entry.

Citizens Advice has highlighted the lack of Customer Continuity Plans, or 'living wills', for recently failed suppliers and the need for Ofgem to implement a consumer duty, similar to that being developed by the Financial Conduct Authority (FCA)[18]. Age UK recommends that the energy regulator give serious consideration to these two recommendations. Age UK's Advice Line has received a marked increase in energy related calls since October. Many of these calls were from older consumers struggling with the uncertainty of the Supplier of Last Resort (SoLR) process. Future regulation must ensure that consumers are better protected and supported during supplier failure. This must include Customer Continuity Plans becoming mandatory for all incumbent and future suppliers.

The misuse of customer credit balances to finance supplier operations must also be addressed[19]. Customers of many recently failed suppliers had credit balances well in excess of what was required, with some suppliers reportedly using them as a mechanism for funding their growth[20]. Misuse of customer credit balances is wholly inappropriate and must be banned. Regulations which prohibit misuse of credit balances must be enforced by Ofgem, with appropriate sanctions for non-compliant suppliers. Ofgem must use its data request powers to gain better oversight of how suppliers are using customer credit balances and if customers are being treated fairly.

The insufficient capitalisation of many failed suppliers was a factor in their demise[21]. The risks that suppliers took are ultimately paid for by all consumers. It is unacceptable for firms operating within an essential service market like energy to have a business model which places undue risk at the foot of customers. The Government and Ofgem must ensure better oversight of how suppliers are preparing for uncertain costs as a matter of urgency. This must include improved data sharing to ensure Ofgem can adequately audit accounts and estimate whether a supplier is overexposed to market volatility. This should include direct access to suppliers' trading practices, including data on whether suppliers have sufficiently hedged for increased wholesale energy prices. Ofgem must put new entrants and incumbent suppliers through stress testing, simulating a range of scenarios to estimate their market viability during times of crisis. If suppliers fail these tests, they should be provided with support to improve performance, and if they are found to be consistently undercapitalised then all enforcement actions, including removal of operating licences, must be considered. Using the Supplier of Last Resort (SoLR) process, customers could be pre-emptively moved to efficient suppliers while minimising any negative impact on consumer bills.

The mandate, role and performance of Ofgem in setting regulation and supervising regulated entities.

The Government must commission an independent review into the causes of the energy crisis, including what role regulatory failure played. Consumers should not be made to pay the price for the mistakes of a permissive regulatory regime. Ofgem allowed numerous inefficient and poorly managed suppliers to enter the market. Its regulatory framework, supervision and enforcement have been insufficient to prevent this crisis and need to be amended to avert future ones.

We are aware that Ofgem already has extensive powers to sanction suppliers[22] and revoke supply licences[23]. But research from Citizens Advice indicated that Ofgem rarely pursues meaningful enforcement of its rules, instead opting to go after suppliers for technical failures with less direct relevance to consumers[24]. Proactive enforcement of existing rules, an improved regulatory framework, better data sharing and higher standards to market entry would help to avert future supplier failures. Ofgem must bring forward these reforms swiftly and focus on minimising consumer risk.

The performance of previous policies introduced to stimulate effective competition within the retail energy market, and an assessment of the impact on competition of proposed future regulatory frameworks.

Age UK has previously encouraged older consumers to check if they are on the most competitive energy deal and switch energy supplier if appropriate. Recent market conditions have meant that switching has become generally inadvisable. But the

Government's Energy Retail Market Strategy is geared towards switching as a means of fostering supplier competition and reducing consumer costs[25]. The Government's own proposals for opt-in and opt-out tariff switching reinforced the expected positive impact for market disengaged consumers of minimal input switching mechanisms[26].

While we welcomed these practices longer-term, subject to our proposed reforms[27], they are inappropriate in a context where supplier switching is no longer viable and, in many cases, can be costly for consumers. During the energy crisis customers lured by cheaper deals frequently found themselves moving to a supplier who was unable to sustain the prices they offered – resulting in supplier failure. Customers switched from failed suppliers through the SoLR process saw their bills increase by an average of £30 a month[28], and all consumers are expected to be hit with a £100 bill for the cost of supplier failures from April[29]. Recent Ofgem proposals for mitigating supplier volume risk have gone as far as to discourage switching - proposing measures such as default tariff exit fees and Market Stabilisation Charges for suppliers who attract new customers[30].

The Government need to go back to the drawing board with its Energy Retail Market Strategy and reconsider how to foster competition and improve consumer outcomes. This rethink must be consumer focused.

In the short-term, measures to reduce market competition and discourage switching must be mitigated by alternative ways for vulnerable and fuel poor older households to reduce their energy bills. With bills going up by an expected £600 from April[31] and in the absence of an appropriate switching framework, £500 direct payments to consumers and VAT exemptions on energy must be enacted immediately.

Longer term, the Government will need to rethink tariff switching and the available tariffs in the energy market. Ofgem's revised regulatory framework and the Government's ambition for supplier switching must go hand in hand. Sufficient improvements in Ofgem's regulatory oversight could provide confidence that people are switching to an efficient, well-regulated supplier that is financially resilient enough to cope with wholesale price fluctuations. This could allow switching to once again become a viable method of keeping on top of consumer bills. The Government must also be mindful that new products and developments in the energy market (such as time of use tariffs and greater levels of at home electric vehicle charging) could add additional complexity to consumer energy contracts. An improved regulatory framework must account for these developments to ensure tariff switching and supplier competition benefits consumers.

Beyond switching tariff, the Government will need to also consider the appropriateness of existing tariffs. Social tariffs would provide a viable safety net for low-income and vulnerable consumers struggling with their bills. The Government must consult on the reintroduction of improved social tariffs and legislate for the extension of the Price Cap beyond 2023.

With, at most, two thirds of customers switching or comparing energy deals over a given 12-month period[32], the Government must also provide greater consideration to the impact of the energy crisis on market disengaged consumers. These customers often remain on standard variable tariffs for many years and are now facing even higher bills. Market disengaged customers are more likely to be in vulnerable circumstances[33] and often face higher barriers to switching supplier. Stronger price protections are essential to keep costs affordable for market disengaged consumers.

The functioning and performance of the 'energy price cap' and an assessment of its use in the future, and an assessment of the role of auto-switching

The Energy Price Cap (the 'Cap') is an essential price control - the Government must legislate for its extension beyond 2023. The Cap ensures older consumers on standard variable tariffs know how much they will pay per unit of energy during colder periods. Without it in place April's expected price increases of 50% or more would almost certainly have been added to consumer bills this winter. With older people being both more likely to live with the health conditions which require more heating or energy use[34] and having higher heating costs[35], the Cap has proved vital in protecting them this winter.

While Age UK is cognisant of the issues faced by suppliers in the last few months, we are committed to ensuring that the needs of older consumers, particularly those in vulnerable circumstances, are foremost in the minds of policy makers and Ofgem. We are aware of a range of Ofgem proposals for Price Cap reform made over recent months including emergency adjustments to the Cap under exceptional circumstances[36], quarterly Cap changes[37] and changes to risk allowances[38]. We have responded to each of these proposals in turn[39][40][41]. While minor changes may be needed to improve the responsiveness of the Cap, reduce supplier volume risk and enhance the ability for the energy market to weather price volatility, the cumulative impact of Ofgem's multiple complex changes is likely to undermine consumer protections. This could unfairly shift market volatility risks away from suppliers and onto consumers.

As stated, Age UK have called on Ofgem to review and improve its own regulatory framework before enacting sweeping reform[42]. If better enforcement of existing rules, improved regulation, and higher standards thresholds for market entry would be sufficient to avert future crises then we question the need for wider Price Cap reforms. Ofgem must also commit to explore less radical reforms, such as assessing measures it could use to reduce the 8-month time lag between forward wholesale prices and their recovery through the Cap using existing measures.

Quarterly Price Cap changes appear to be the frontrunner of Ofgem's proposed Price Cap reforms. This would mean that Price Cap changes during the winter months would be inevitable. We strongly disagree with quarterly changes and any other Cap modification which could result in prices being able to increase during the coldest periods[43].

During verbal consultation we proposed a compromise solution of Cap changes three times a year, in mid-November, March and July. We strongly recommend that

Ofgem pursue this option and reinforce the need for any Price Cap reform to avoid passing additional cost onto consumers during colder periods. Quarterly Price Cap changes risk older consumers self-rationing and self-disconnecting their energy supply when they need it most. This is compounded by energy bills generally being higher during the winter as demand and prices often increase during colder months[44].

Auto-switching services present opportunities for some customers to make efficient supplier switches with minimal effort. In principle this should provide a benefit to consumers. But in practice badly regulated auto-switching services can be detrimental for consumers and the wider energy market. Research has shown that it is hard for customers using auto-switchers to specify good customer service as a switching criteria and users often find it difficult to ascertain if they are on the best deal[45]. A lack of regulatory oversight over auto-switching services was one of a range of factors which enabled unsustainable pricing of fixed-tariff deals by new entrants into the energy market[46]. In recent years this has forced larger suppliers into offering loss-making tariffs.

Age UK are not inherently against using improved switching services to streamline the process of accessing a better energy deal once market conditions are sufficiently stable to facilitate switching. Subject to our recommended reforms, we welcomed longer-term Government efforts to address the energy market loyalty penalty using similar systems to auto-switching – including opt-in and opt-out switching[47]. But our view is that auto-switching must be appropriately regulated and monitored to ensure associated market instability is avoided. This will require comprehensive reform of the regulatory framework. Auto-switching services must also be fully transparent for consumers. This will allow them to assess if they are truly on the best deal and specify wider preferential switching criteria, including vetting a supplier's customer service credentials and obligations to support schemes such as the WHD.

The future of Bulb and the recovery of public funds and the cost to consumers of other energy supplier failures.

The Government and Ofgem should avoid immediately recouping supplier failure costs during a single Price Cap period. After April consumers are expected to be hit with a £100 bill just for the cost of supplier failures[48]. Customers switched from failed suppliers through the SoLR process have already seen their bills increase by an average of £30 a month[49]. With the average energy bill expected to increase by around £600 from April[50] we recommend that the recovery of funds associated with 2021/2022 supplier failures should be stretched out across several years instead of collected in the next Price Cap window between April to October.

The latest government figures show that around 930,000 pensioners (eight per cent) say they could not afford an unexpected bill of £200[51], let alone the £600 expected in April. A £600 energy bill increase is the equivalent of spending an extra £1 in every £15 of the full new State Pension (nSP) on energy[52]. Anything the Government can do to reduce the financial burden associated with supplier failures from April would provide welcome relief to older consumers already struggling with expensive energy bills. This must include mitigating the £100 supplier failure bill expected to hit consumer bills over the next Price Cap period by stretching this cost over several years.

The outlined increases in consumer bills due to supplier failures do not include the financial cost of bailing out Bulb. We strongly recommend that the costs associated with Bulb are recovered through general taxation rather than directly through consumer bills. This will ensure a progressive recovery of funds rather than it falling equally on those least able to pay.

The role of retail market reform in the context of the UKs net zero transition and domestic energy security requirements.

The primary reform required in the energy retail market to facilitate the transition to net-zero is better funding of household energy efficiency programmes[53]. A core commitment of the Government's Energy Retail Market Strategy was to ensure that adequate consumer protections are in place to support people unable to meaningfully engage with the energy market and to help them bear the costs of the transition to net-zero[54]. We strongly reinforce the need for the Government to set a higher ambition for energy efficiency and heating system funding if it is to achieve net-zero and ensure that low-income and fuel poor households are not excluded from the net-zero transition. This must include a commitment to honour proposals for an improved and better funded Energy Company Obligation scheme (ECO4).

Overall estimates suggest £12 billion of additional spending beyond existing commitments will be needed to meet statutory fuel poverty obligations by 2030[55]. This money is required to truly address the lack of support for energy efficiency and improved heating systems, particularly amongst low-income and fuel poor households. This analysis was also undertaken before the impact of current increases in energy costs and wider inflation rises – so this is likely to be an underestimate of the amount required. Alongside direct financial support for low-income households the Government must also consider incentives for wider households. These could include tax incentives and VAT exemptions. Longer term, household energy efficiency will reduce the risk of surging energy prices causing a repeat of the energy crisis.

We also agree with Citizens Advice's recommendation that all suppliers take on a fair share of net zero transition costs to ensure a level playing field for suppliers[56]. In this regard, we welcomed the Government's proposal[57] to reduce and eventually remove ECO customer obligation thresholds[58] and supported similar proposals for the WHD[59].