Citizens Advice response to Ofgem's Energy price cap: updating the time-of-use methodology call for input

Citizens Advice welcomes the opportunity to respond to this consultation. We support the need to reform the multi-rate price cap in light of Market-wide Half-Hourly Settlement. We are supportive of the aims of the updated time-of-use (ToU) approach, namely to provide more consistent outcomes for default tariff customers and set a cap that is not a blocker to consumer-led flexibility, by enabling incentives for innovation and tariff diversity.

To achieve these outcomes, we are broadly in support of the criteria Ofgem set out to assess the options. However, we think further clarification and refinement is needed on the flexibility and innovation and consumer experience criteria. Further, Ofgem should make clear that the options should primarily be assessed against the core function of the price cap, which is to serve as a price protection mechanism to ensure consumers pay fair prices for the service they receive, with the additional criteria treated as secondary.

Under the current multi-rate price cap the primary aim has been partially undermined, since shaping costs have been set using the demand profile of single-rate consumers. As multi-rate consumers are more likely to have higher off-peak demand, shaping costs have been over-stated which has allowed suppliers to over-recover from multi-rate consumers. We think that ensuring there is not over-recovery by suppliers on average across their consumer base should be a central consideration when assessing the time-of-use cap options going forward.

Ofgem sets out the challenges of using a single or blended demand profile to reflect increased cost diversity across consumers on the multi-rate cap, leading to potential over- or under- recovery. To evaluate these concerns and to support the design of the time-of-use cap, we think it is important for Ofgem to explore how fast cost-diversity is increasing for consumers on the time-of-use cap,

identify which types of consumers are likely to be captured by it, and set out the expected impact on these consumer types under the different options it is considering. For instance, the Call for Input raises difficulties with setting an appropriate rate cap for a hypothetical example of a market with EV consumers and heat pump consumers only. However, we question how many heat pump consumers without battery storage would be on a time-of-use default and why.

We do not think Ofgem should aim to design a perfect time-of-use price cap that can account for every type of consumer, regardless of whether the time-of-use default is appropriate for them. Rather, the price cap should offer broad protection paired with clear default arrangements, whilst attention is also given to supporting consumers with finding the best tariff for their circumstances and engaging in the active market, where appropriate.

Assessment criteria

We are broadly supportive of the options being assessed against flexibility and innovation, as we recognise that innovation plays a vital role in helping to reduce costs, improve consumer outcomes, and support the growing electrification of the energy system. In our Stuck in the Sandbox report, we identified that consumers are open to innovation, particularly where it is simple to engage with and where benefits are clear and tangible.

The flexibility and innovation criteria is measured as the extent to which each option supports a supplier's ability and willingness to innovate in the tariff space and provide clear price signals through its pricing. Ofgem links a supplier's willingness to innovate to a potential risk of under-recovering costs if active customers later roll onto a default tariff. However, that cost-recovery risk is already captured by the standalone cost-reflectivity criterion and should not be double-counted here. Instead, the flexibility and innovation criterion should largely focus on an option's ability to deliver price signals and give consideration to how heavily price signalling should be weighted when setting a default tariff.

Further, if Ofgem considers the risk of active customers defaulting to be a material barrier to active-market innovation, this concern should be evidenced. Specifically, we would encourage further exploration by Ofgem on how many active time-of-use consumers Ofgem expects to roll onto a default tariff, which types of consumers this is a risk for, and to what extent that default risk genuinely constrains active market offerings. We consider that wider regulatory

reforms, such as changes to the Universal Service Obligation and the move towards Outcomes-Based Regulation, could be more pertinent to facilitating innovation in the active market.

In relation to the consumer experience criteria, the Call for Input sets out that this is measured in relation to:

> (i) The extent to which each option provides an appropriate reflection of costs.
>
> (ii) The extent to which each option supports a clear and appropriate customer experience when customers move from fixed tariffs to a given default tariff under the option.

However, i) is already captured by the separate cost-reflectivity criterion, which already helps to ensure that the cap is an appropriate reflection of costs, in that suppliers can recover their efficient costs from a diverse range of consumers, which we support. The customer focused criteria should instead focus on ensuring that recovery is fair. Further, in the consumer experience commentary for each option, i) is largely conflated with more consistent tariff pricing across suppliers. Yet, consistency across suppliers does not guarantee a fair price if the underlying cap methodology allows systematic over-recovery.

In relation to ii) we believe a clear and appropriate customer experience when customers move from fixed tariffs to a default is important but largely managed by getting the default arrangements right. The consumer experience commentary does rightly touch on the separate area of ease of tariff comparison for consumers engaging in the active market and this should be the primary emphasis of the criterion. Regarding default arrangements, we would expect them to require suppliers to broadly assign consumers onto a default in line with the tariff they rolled off from, i.e. fixed flat tariff consumers onto the flat default and time-of-use tariff consumers onto a time-of-use default that is similar in nature.

Our view is that it would be in the interests of consumers generally for it to broadly be mandatory for EV users to be on a time-of-use tariff, whether active or default. This is to ensure that EV charging during peak times does not lead to increased system costs for all. If an EV consumer rolls off of a fixed flat tariff then it would be appropriate for them to be moved onto the time-of-use default. We

would welcome clarity on how default arrangements will be developed to accommodate the time-of-use default.

We believe the consumer criteria should be revised to reflect the following:

> i) Consumer fairness - the extent to which each option can deliver fair pricing for consumers, specifically, ensuring that suppliers cannot systematically over-recover against their efficient cost to serve and that operating and profit margins remain fair, on average across their consumer base.
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> ii) Consumer confidence - the extent to which the options support consumer confidence to engage in the active market, and trust the prices they are offered are fair.

Options assessment

Option 1

Citizens Advice believes option 1, the simple time-of-use approach, could be in the interest of consumers. Ofgem should be able to set the unit rates at a level which provides a fair reflection of costs and profit margin. However, finding the right level at which to set the rate to reflect a diverse range of consumer types on the time-of-use default could be challenging. This is why we recommend Ofgem to further explore which types of customers are likely to end up on this default rate so the rates can be set at the most appropriate level. We also note that it is not feasible for option 1 to be set perfectly, and there will likely be some over and under recovery across consumers with this approach. The key consideration is that suppliers are not over-recovering on average across their consumer bases.

Our Stuck in the Sandbox report identified that there is openness to a simple time-of-use price cap, but consumers were sceptical of options that required closer monitoring of prices, major adjustments to their behaviour or managing multiple services. Option 1 is the simplest to understand and supports consumer confidence and trust in the market. With Ofgem specifying a unit rate for the different time bands, consumers may have greater confidence that the time-of-use default rate is set fairly, and it most directly corresponds to how the flat default rate is set which consumers are familiar with. It also provides confidence to consumers wishing to engage in the active market, as consumers

have a simple baseline by which to compare tariffs, for instance, using price comparison websites.

As the Call for Input recognises, consumers still need to understand their usage patterns to assess time-of-use tariffs in the active market, if this data is not already provided to price comparison sites through, for example, the DCC. Ofgem must ensure that suppliers are providing consumers with the data necessary for them to make an informed choice.

There is a risk with option 1 that consumers on highly tailored time of use tariffs see a price increase when defaulting. The impact could be greater for people who are defaulting and have built up debt which means they can't easily switch away. The extent of the price differential and risk to consumers should be monitored if this option is taken forward.

Option 2

Citizens Advice has concerns that option 2 may not be in the interest of consumers, due to the practicality of setting a time-of-use cap for different use purposes. This would require suppliers having accurate data on consumer's use-type, for instance, whether they own LCTs, and accurately categorising their consumers. If not done well, this could result in consumers being on the wrong default rate for their situation. However, as set out above, we do think there could be wider consumer benefits if EV drivers are required to move onto a ToU default, if this reduces the cost to serve single rate default consumers. The same considerations around the need for robust data on use-types would apply.

In relation to consumer confidence with engaging in the active market, this option is equivalent to the status quo multi-rate cap, and without explicit unit rates does not provide consumers with a benchmark with which to compare offers on the active market. It could become even more challenging for consumers to infer unit rates with multiple caps for different types of consumers, with different demand profiles.

Option 3

Citizens Advice believes option 3, the tariff specific assessment, could be in the interest of consumers. Ofgem being able to effectively monitor compliance, and

so take enforcement action where necessary, is essential for option 3 to support fair prices for consumers. If done well, this option could increase competition amongst suppliers, allow them to offer a greater diversity of default and active offerings and drive better consumer outcomes. We support outcomes based regulation more generally for the same reasons. There may also be a subset of consumers for whom this option provides some confidence, for example, consumers on more complex fixed time of use tariffs may value rolling onto a tailored default which is more cost-reflective to them, rather than onto a simple time of use default which could be more expensive.

Option 3 is weakest in terms of providing consumer trust and confidence, due to absence of a publicised cap applying to all suppliers. Even though the status quo, option 1 and option 2 differ in whether an average cap with an implied unit rate or explicit unit rates are published, their commonality is that a clear cap benchmark is publicly available. This visibility alone helps build consumer trust in suppliers and Ofgem, and gives households confidence to engage in the active market.

Further, option 3 faces the same logistical issues as option 2 in terms of suppliers being able to accurately assign consumers to the correct time-of-use default where multiple variants exist. This could result in consumers being on the wrong time-of-use default and lead to higher costs than necessary. Development of Ofgem's outcome that consumers are 'charged energy prices that represent fair value' and associated guidance could ensure that firms are allocating consumers to the most appropriate default available, based on the characteristics of their fixed term deal.

Whilst we believe the flexibility and cost-reflectivity provided by option 3 could benefit consumers, it is important to remember that the price cap was developed precisely because competition was not working and disengaged consumers faced poor outcomes. Ofgem would need to demonstrate that this open approach could be robustly monitored before applying it to the default space. Consideration would then need to be given to how the approach was communicated to consumers, to support consumer trust and confidence. For example, suppliers could be required to consistently publish their default rates, and/ or a database publishing tariff compliance could be made available.