

Response to ESNZ Committee's call for evidence: Energy bills for domestic customers

1st February 2024

About Fair By Design

Fair By Design is dedicated to reshaping essential services such as energy, credit, insurance and payments so that they don't cost more if you're poor – also known as the poverty premium. Fair By Design collaborates with regulators, government, and industry to design out the poverty premium. Our Venture Fund provides capital/funding to grow new scalable ventures to innovate the market and design out the poverty premium. Ascension manages the Fair By Design Fund. Fair By Design is managed by the Barrow Cadbury Trust on behalf of a group of foundations.

In the context of the energy market, we believe that households on low incomes/living in poverty should not incur a poverty premium based on the way they pay for their energy or for not actively engaging in the market.

Summary

The Energy Security and Net Zero (ESNZ) Committee launched this inquiry to investigate the process of billing customers for their gas and electricity, to look at whether the rules on charging for energy are fair for all. Fair By Design welcomes the opportunity to respond to this inquiry.

- Fair By Design believes that standing charges are too high, meaning that they make up a high proportion of the bill and hence disproportionately impact low-income households. Ofgem needs to look at recovering the costs of the energy system in a fairer way.
- Fair By Design would like to see an end to premiums for different methods of payment, particularly when those methods of payment are disproportionately used by those on a low income (“poverty premiums”).
- Fair By Design wants to see the introduction of an energy social tariff as soon as possible. There is an ongoing affordability crisis in energy. Prices are forecast to remain significantly above their pre-crisis levels for many years to come. **The Government needs to urgently honour its commitment to consult on introducing long-term bill support for those least able to afford their energy.**

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

Fair By Design believes that standing charges are too high and that Ofgem should look to recover the fixed costs of the energy system in a fairer way. Reducing standing charges would benefit the majority of low-income consumers (around 5.5m of the lowest income decile for electricity), although 1.2m low-income households (including those who have high energy needs linked to a disability or long-term health condition) would be worse off. This could be mitigated by other measures, however many of these are within the Government's control.

Ofgem's justification for standing charges is that these represent the fixed costs of the system (ie those that don't vary with how much energy you use such as the costs of providing networks, billing and metering, and the policy costs of Government schemes such as the Warm Home Discount). Therefore, Ofgem has traditionally taken the view that these costs should be recovered equally from all consumers using the energy system. Ofgem has also been clear that they do not require suppliers to impose standing charges on domestic consumers. However, it is less risky for suppliers to recover the fixed costs they face in the form of standing charges, hence there are only 3 suppliers out of 37 currently offering a tariff without a formal standing charge. However, even on these tariffs, domestic consumers pay more for the first 2kWh each day which effectively acts as a standing charge¹.

Standing charges for domestic electricity customers have increased significantly since 2021. For a customer who pays for their electricity bills by direct debit, they have more than doubled from £86 per annum to £186 per annum on average between 2021 and 2023. Gas standing charges have remained relatively stable over the same period.

This means that for low-income households who are trying to minimise their energy usage as much as possible, a much higher proportion of their bill is made up of standing charges, and there is very little they can do to reduce their energy usage further. It also means that even when a household turns their gas central heating off completely or is told not to use gas because their appliances are unsafe, they still incur standing charges. Furthermore, those on pre-payment meters who want to add credit or a fuel voucher to their meter, have to pay off their backlog of standing charges before any energy can be used. People on low incomes have told us that they feel strongly that this is unfair. We have urged Ofgem to focus on these situations where low-income households are contributing a significant amount towards the energy system (over £300 per year) when they cannot even afford to eat hot food or heat their home.

However, we recognise that this is a complex issue. We do not advocate the abolition of standing charges altogether as it is the more privileged in society who are most likely to be

¹ Ofgem (2023). *Standing charges - call for input*. [online] Available at: <https://www.ofgem.gov.uk/publications/standing-charges-call-input>

able to avoid additional unit rate charges through installing solar panels for example. In addition, there is not a strictly linear relationship between income and energy usage, and so a minority of low-income households would be worse off if standing charges were to be reduced. We would like to see the Government and Ofgem addressing energy affordability in a holistic way. If a social tariff was in place, it would be much easier for Ofgem to act in the interests of most low-income consumers, knowing that there was a safety net for low income/high energy need households who were adversely impacted. Ofgem acting on its own does not have the tools needed to address energy affordability – it can only reallocate costs between customers.

2. Should companies be allowed to provide cheaper bills to those who choose to pay by Direct Debit?

Fair By Design would like to see an end to premiums for different methods of payment, particularly when those methods of payment are disproportionately used by those on a low income (“poverty premiums”).

We welcome Ofgem’s recent consultation on levelisation of payment methods². Ofgem’s preferred option, if implemented, would end the pre-payment meter premium on an ongoing basis and also reduce the standard credit premium by around 50%. However, the standard credit premium would still be around £62 for the price cap period used as a baseline in the consultation.

Ofgem argues that those who pay by different payment methods should bear the extra costs of those payment methods and that a price differential needs to be kept to encourage people to switch to cheaper payment methods which will ultimately reduce costs for all consumers.

We believe this argument is fundamentally flawed. As a precondition, this would require people to be aware of the price differential. Ofgem’s own consumer research³ shows that only **24% of people on standard credit know that it is more expensive than direct debit**. . The same research shows that the number one reason people choose to pay by standard credit is to maintain control of their payments and the most popular reason for choosing direct debit is convenience rather than cost. Ofgem is therefore a long way from being able to make the case that maintaining a standard credit premium incentivises efficient payment methods.

² Ofgem (2023). *Changes to prepayment meter standing charges and other debt costs*. [online] Available at: <https://www.ofgem.gov.uk/publications/changes-prepayment-meter-standing-charges-and-other-debt-costs>

³ Ofgem (2023). *Consumer Impacts of Market Conditions survey - Wave 4*. [online] Available at: <https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-4-july-2023>

On the other hand, a clear theme emerging from the focus groups we ran with our partner Poverty Alliance in April 2023 with people on low incomes, was that the current system is too complicated. We believe that getting rid of premiums associated with different payment methods would help to rebuild trust in the energy market – albeit with a safety net, such as a social tariff, for those who cannot afford a basic amount of energy.

It is worth comparing Ofgem’s approach to the approach of Ofwat in the water sector (energy and water being among the small number of industries under Regulation 4 of the Consumer Rights (Payment Surcharges) Regulations⁴ where suppliers are legally allowed to charge a cost-reflective premium for different payment methods). Our understanding is that Ofwat has always expected companies to average the cost differences between different payment methods between customers rather than seek to reflect different costs at individual customer level. One company, United Utilities, voluntarily offers a discount to direct debit customers of £5 for paying by direct debit⁷. Much like the 5p plastic bag levy which reduced the sale of plastic bags by 95% after it was introduced in 2015, we believe it would be interesting to explore whether a much smaller but better-publicised discount might incentivise a switch to direct debit. We believe there are lessons to learn for the energy sector from this positive framing/competition-enabled approach. It offers a potential route to incentivising companies to raise awareness of such a discount, encouraging efficient payment methods, whilst also ensuring these price differentials are much smaller and transparent.

This is particularly important in a world where payment methods will continue to evolve. The current delineation into three payment methods: pre-payment meter, standard credit and direct debit is already an oversimplification. “Dumb” pre-payment meters are more costly to serve than smart pre-payment meters but no differential is charged. Some firms also offer flexible direct debits at no extra charge, which are presumably more costly to offer but may result in more customers staying on track with their payments. Variable recurring payments using open banking will be rolled out to energy and other utilities shortly with the potential to give more consumers greater flexibility in how they pay. Fair By Design would like to see Ofgem encouraging suppliers to offer a greater range of payment methods, to help consumers budget and control payments in a way that suits them. Ensuring current premiums are eliminated and that new premiums do not develop alongside new payment methods is a key contribution Ofgem can make to enable consumers on low incomes to manage their energy payments.

⁴ *The Consumer Rights (Payment Surcharges) Regulations 2012*. 2012 SI 2012/3110 [online] Available at: <https://www.legislation.gov.uk/uksi/2012/3110>

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?

We welcome the new guidance introduced by Ofgem on involuntary prepayment meter installations⁵, following the shocking breaches by debt agents working for British Gas uncovered by The Times newspaper in February 2023⁶.

We do not know whether pre-payment meters are necessary to deter fraud and theft but we do know that millions of people are struggling to pay their energy bills at present and are deeply concerned that energy suppliers must be able to distinguish between a household that won't pay and a household that can't pay and needs support.

We were particularly pleased that the new guidance requires the same level of due diligence for switching a smart meter into pre-payment mode, as for physically installing a pre-payment meter. Switching a smart meter to pre-payment mode is much easier for the energy supplier to do, and we believe this practice contributed to reducing trust in smart meters prior to the introduction of the latest code of practice. This presents a real difficulty for the Government and Ofgem as completion of the smart meter roll out is a requirement to be able to run an efficient and fit-for-purpose energy system going forward. It also gives suppliers a more accurate picture of a household's consumption behaviour, which should give the supplier the ability to offer timely support to their customers when needed.

The new guidance came into effect in December, and three suppliers were given approval by Ofgem to resume forced installations at the beginning of January⁷. We hope that suppliers will comply with the new guidance and that it will be effectively enforced. If not, Ofgem will need to ban forced installations of pre-payment meters.

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

⁵ Ofgem (2023). *New rules for installing involuntary prepayment meters* [online] Available at: <https://www.ofgem.gov.uk/publications/new-rules-installing-involuntary-prepayment-meters>

⁶ Morgan-Bentley, P., (2023). Exposed: How British Gas debt agents break into homes of vulnerable. *The Times*, [online] Available at: <https://www.thetimes.co.uk/article/british-gas-prepayment-meter-debt-energy-bills-investigation-wrgnzt6xs>

⁷ Ofgem (2023). *Ofgem sets out prepayment meter expectations to energy bosses as EDF, Octopus and Scottish Power meet regulator's restart conditions* [press release] 8th January 2024 Available at: <https://www.ofgem.gov.uk/publications/ofgem-sets-out-prepayment-meter-expectations-energy-bosses-edf-octopus-and-scottish-power-meet-regulators-restart-conditions>

We do not have a view on the Government's proposal in the Autumn Statement that households close to transmission infrastructure (e.g. pylons and sub-stations) will receive a discount on their electricity bills⁸.

However, there are much wider issues of fairness within the energy system that are not addressed by this proposal. First and foremost, the issue of energy affordability needs to be addressed. We would like to see those who cannot afford a basic level of energy given a discount, as a matter of urgency.

In addition, this proposal does not address issues such as higher standing charges for those in certain regions of the country including in Scotland, despite a lot of our renewable generation capability being based there (see response to question 5 below).

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

No, it is not. Fair By Design would like to see regional differences in energy prices abolished. People on low incomes have told us that they want the energy system to be less complicated and fairer:

"The pricing and tariffs are over complicated on purpose. Energy companies have far too much power for an essential service."

"It's wrong. Everyone should be paying the same."

(Quotes from focus groups held by Fair By Design and Poverty Alliance with people with live experience of poverty in April 2023)

Most people do not know that there are regional differences in energy prices. Ofgem's consumer research⁹ found that only **42% of consumers know that the cost of energy varies according to whereabouts in the country you live**. The lack of transparency over energy pricing contributes to a lack of trust in the energy system. Ofgem's latest consumer research¹⁰ shows that only one in three people trust the energy sector and that energy companies have lower levels of trust than banks/building societies, internet providers and insurance companies.

⁸ Department for Energy Security and Net Zero (2023). *Community Benefits for Electricity Transmission Network Infrastructure – Government response*. Available at:

<https://assets.publishing.service.gov.uk/media/655cda1dd03a8d000d07fe0b/community-benefits-for-electricity-transmission-network-infrastructure-govt-response.pdf>

⁹ Ofgem (2023). *Consumer Impacts of Market Conditions survey - Wave 3*. [online] Available at: <https://www.ofgem.gov.uk/sites/default/files/2023-05/CIM%20Wave%203%20Report.pdf>

¹⁰ Ofgem (2023), *Consumer Impacts of Market Conditions survey - Wave 4*. [online] Available at: <https://www.ofgem.gov.uk/publications/consumer-impacts-market-conditions-survey-wave-4-july-2023>

The Scottish Affairs Committee¹¹ has recently highlighted the “rural premium” already paid by many people in Scotland and other rural areas due to higher energy costs from more severe winters and more homes being off-grid, as well as higher transport and food costs. At present this rural premium is compounded by higher energy prices in Scotland, North Wales and other areas¹². Fair By Design believes these regional charging differentials should be abolished. If there are differentials, they should be in the form of discounted prices for those who are less able to pay for their energy.

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

Fair By Design, alongside over 90 other charities and third sector organisations¹³, Ofgem¹⁴, and the energy industry¹⁵ wants to see the introduction of a discounted energy tariff targeted at those most in need.

A social tariff must be funded by Government to ensure that funding is progressive and that exaggerated cliff edges are not created whereby those who just miss out on eligibility end up shouldering the financial burden of funding this discount for others.

We want to see this tariff made mandatory for all energy suppliers, and for eligible households to be automatically enrolled to remove any barriers to take up.

We know that many of the lowest income households are not on benefits¹⁶ and therefore it is essential that eligibility extends to those on low incomes, but who are not on benefits,

¹¹ House of Commons, Scottish Affairs Committee (2023). *Cost of living: impact on rural communities in Scotland* (HC 153, First report of session 2023-24). Available at: <https://committees.parliament.uk/committee/136/scottish-affairs-committee/news/199546/remote-scottish-communities-worse-off-due-to-rural-premium-despite-cost-of-living-support-mps-find/>

¹² Ofgem (2023). *Get energy price cap standing charges and unit rates by region*. [Online]. Available at: <https://www.ofgem.gov.uk/information-consumers/energy-advice-households/get-energy-price-cap-standing-charges-and-unit-rates-region>

¹³ Fair By Design (2023). *Fair By Design one of over 90 charities and non-profit organisations calling on the Chancellor to introduce discounted energy bills for low-income households* [press release] 17th January 2023. Available at:

<https://fairbydesign.com/news/press-release-fair-by-design-one-of-over-90-charities-and-non-profit-organisations-call-on-the-chancellor-to-introduce-discounted-energy-bills-for-low-income-households/>

¹⁴ Ambrose, J., 2023. ‘Change is needed’: Ofgem chief calls on ministers to rethink energy price caps. *The Times* [online] 14th Aug. Available at:

<https://www.theguardian.com/business/2023/aug/14/change-needed-ofgem-chief-rethink-energy-price-caps>

¹⁵ Energy UK (2023) *Government must switch on to help vulnerable energy customers this winter* [online] Available at:

<https://www.energy-uk.org.uk/news/government-must-switch-on-to-help-vulnerable-energy-customers-this-winter/>

¹⁶ Schmuecker & Elliott (2023), *On a low income but not claiming means- tested benefits* [online] Available at: <https://www.jrf.org.uk/social-security/on-a-low-income-but-not-claiming-means-tested-benefits>

who are struggling to afford their energy. Research by Age UK¹⁷ shows that almost half of those in the lowest two income deciles would miss out on the social tariff if the eligibility criteria was based on receipt of benefits alone, but everyone in the lowest two income deciles would be eligible for a social tariff if the criteria included those on low incomes. This will require the ability to match different data sets across central and local Government and data held by suppliers to identify eligible households accurately. We would like to see the Government carrying out this work as quickly as possible. Had this been done, the Government would have been able to target the Energy Price Guarantee at those who needed support, rather than offering a universal cap, which would have saved the taxpayer billions of pounds.

Our preferred form of social tariff would be a significantly discounted rate with no standing charge for eligible households. **However, the most important thing is for the Government to honour its promise to consult on energy bill support so that all views can be considered, and a solution reached.**

¹⁷ Karania, V., (2023), *Distributional impact of differing proposals for the introduction of a Social Tariff for energy use at home* [online] Available at: <https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/safe-at-home/distributional-impact-of-differing-proposals-for-introducing-an-energy-social-tariff-june-2023.pdf>