The voice of the energy industry

Energy UK Written evidence: Energy bills for domestic customers

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members - from established FTSE 100 companies right through to new, growing suppliers, generators and service providers across energy, transport, heat, and technology. Our members deliver nearly 80% of the UK's power generation and over 95% of the energy supply for 28 million UK homes as well as businesses.

The sector invests £13bn annually and delivers nearly £30bn in gross value - on top of the nearly £100bn in economic activity through its supply chain and interaction with other sectors. The energy industry is key to delivering growth and plans to invest £100bn over the course of this decade in new energy sources.

The energy sector supports 700,000 jobs in every corner of the country. Energy UK plays a key role in ensuring we attract and retain a diverse workforce. In addition to our Young Energy Professionals Forum, which has over 2,000 members representing over 350 organisations, we are a founding member of TIDE, an industry-wide task force to tackle Inclusion and Diversity across energy.

Response

Thank you for the opportunity to provide evidence to the Select Committee on these important issues relating to customer energy costs.

Many of the questions seek to address whether there is an opportunity for cheaper and fairer charging of energy bills. At a high level, it is our view that there is scope for Ofgem to support the optimisation of the energy system and enable innovation that reduces bills for customers through downward pressure on wider system costs. However, the main drivers of the affordability challenge facing customers are high wholesale prices and broader cost of living pressures – neither of which can be solved by regulatory interventions or supplier initiatives.

Moving to a world of more affordable energy requires the Government to tackle a number of strategic issues including reducing our dependence on gas; improving our energy inefficient housing; and developing a targeted support mechanism for households suitable for an era of high prices and volatility. Support could then be scaled back over time based on a reduction in fuel poverty resulting from either falling prices or improved building efficiency.

While it is sensible to consider how we ensure pricing is as fair as possible in the absence of these interventions, it is also important that we are conscious of the trade-offs and limitations of approaches that simply redistribute costs within the system. It is important any such changes carefully weigh up the risks, including the impact on overall costs, efficient incentives and unintended distributional impacts both now and in the future, particularly as energy suppliers seek to encourage flexible consumption patterns through time of use tariffs.

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

Standing charges have increased by 119% since the winter of 2020.[1] For those with low consumption and low income, this reflects a significantly higher proportion of their energy bill and comes at an already extremely challenging time, given the wider cost of living pressures. It is right for Ofgem to look at options including standing charge reductions that may support affordability for these customers and facilitate better and fairer engagement with the energy market through simpler bills. Ofgem highlights a larger number of low-income households would benefit a small amount and a significant group would see a bigger bill rise.[2] There are always risks of unintended consequences if changes are achieved by passing on costs from one set of customers to another, so it is always preferable that welfare interventions are achieved through progressive taxpayer funding.

A careful distributional analysis of impacts is sensible before any attempts to change or remove standing charges for the purpose of improving social outcomes. As an example, simply removing standing charges would bring big benefits for second homeowners, or customers with expensive retrofits like solar. At the same time, it would lead to increased costs for customers with poorly insulated homes, large families, or those with high energy use for medical purposes. Ofgem does not have the tools to manage these unintended consequences on its own, underlining the need for targeted government support.

The maximum daily standing charge and maximum unit rate are defined under the price cap. Ofgem sets these values based on an estimate of the efficient cost of serving customers. The standing charge element of the price cap corresponds to the supplier's fixed costs – that is the costs that a supplier will incur for supplying a customer, irrespective of how much energy that customer uses. This includes elements such as network charges. We welcome that Ofgem plans to do a post-implementation review of its approach to network charges which is partly responsible for recent increases in standing charges.

As suppliers incur these costs on behalf of their customers, irrespective of how much energy they use, it is efficient for the price cap to pass these costs on to customers at a fixed rate. It reduces the overall risk funded under the price cap of market participants under-recovering their costs. Balanced risk, all things being equal, means lower bills as it maintains the resilience of the market at an affordable cost.

Suppliers are also constrained in their ability to reduce standing charges by Ofgem's decisions on how to allocate network costs which should also be reviewed in the context of a just and fair energy transition. Due to supplier innovation and willingness to absorb costs, there are some tariffs on offer from energy suppliers that set a standing charge below the price cap level. As the energy wholesale market becomes less volatile, we expect to see energy suppliers able to build upon existing products being offered below the price cap, whether through standing charge or unit rate reductions, that will support customers' ability to afford their energy. However, to enable suppliers to innovate in this way, and compete to offer tariff structures that attract customers, the price cap design must support effective price competition in a range of wholesale cost scenarios.

We support Ofgem in seeking to improve energy affordability to all households, however, where possible we favour an approach that will lead to greater customer choice over prescriptive regulatory interventions that try to guess what is best for customers. Overall, it is

[1] Warm this Winter (2024)
[2] Ofgem (2023) Standing Charge: Call for Input 5.26 "Our analysis shows that whilst 5.5 million low-income households would benefit from a decision to move standing charges to volumetric charges in electricity, approximately 1.2 million low-income households would lose out as a result. The average loss per annum for this cohort in electricity under our base case would be almost twice the average annual gain for 'winning' customers."

the cost of energy, rather than the way it is charged, which is causing an affordability crisis for customers though, and this is beyond the means to Ofgem and suppliers to remedy. Progressively funded Government support is a fairer way to share the cost of bill support than charging through energy bills, as it covers a broader range of the population and can be scaled to income. Further, where energy bills have a concerning distributional impact such as for those with low usage and/or are vulnerable, targeted interventions will provide a more effective policy response. A progressively funded, targeted support mechanism, such as an extended, increased and expanded Warm Homes Discount scheme is vital for ensuring bills are fairer and affordability is better protected in the energy market as set out in more detail in response to Question 6.

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

Cost reflectivity – charging customers what a service costs – in the price cap is an important principle. It incentivises suppliers and customers to be efficient and reduce overall system costs, leading to lower overall bills. It also helps suppliers to understand how costs are expected to be recovered and to build products based on predictable costs. Where Ofgem chooses to deviate from the principle of cost reflectivity it introduces cross-subsidisation between different customers' bills. It also means that suppliers need a way to recover the efficient costs of serving their customers. Where there are justifications for deviating from this approach (such as social objectives), there needs to be clarity about how this subsidisation will be paid for.

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?**

Prepayment meter (PPM) tariffs are a vital accessibility tool to support customer engagement with effective energy budgeting. The relative similarity of cost to serve between Smart PPM and Direct Debit also makes it an efficient and reasonable adjustment for millions of customers who proactively choose it as a payment method.

The necessity for involuntary prepayment installation as a last resort for limiting debt is also a key requirement to control energy costs. Suppliers have extensive debt journeys to try and ensure customers engage and that those who can afford to pay do so. Involuntary prepayment is an option only where no constructive engagement can be had with the customer through the debt journey. For some customers, it becomes the only viable solution left to limit the build-up of unsustainable debt. Suppliers have a duty to only forcibly enter a home in extreme circumstances and Ofgem has made its views on how to go about this very clear. For some customers, it will not be appropriate, and the new Code of Practice brings important clarity and consistency over the characteristics that make prepayment unsuitable.

This new regime is being extremely closely monitored by senior executives within suppliers and by Ofgem on a weekly basis. This will help certain customers manage their debts better and reduce the overall cost of energy for all customers, whilst protecting the most vulnerable.

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

We welcome the use of community benefits to improve the acceptance of critical national transmission and generation infrastructure. This helps the most efficient infrastructure to be built and provides recompense to communities impacted by energy infrastructure.

However, we believe that the guidance should allow for flexibility - such that individual community benefit packages can respond appropriately to the needs and desires of the local community in question. Communities may wish to see outcomes different than direct benefits and these views should be taken into consideration. For example, many of our members operate their community benefit funds in collaboration with local communities who opt to spend money to support those suffering from fuel poverty and provide investment in energy efficiency, so addressing the root cause of higher than otherwise domestic energy bills.

There are a wide variety of innovative community and commercial schemes that have demonstrated benefits of both embracing community and direct customer benefits. We believe that guidance needs to be flexible to allow for the desires of the local community to be considered. Mandating bill discounts could hamper the flexibility required to cater and adapt to local circumstances.

To reach Net Zero we will require new energy infrastructure, which will not impact customers equally and therefore there is scope to reflect that in commercial arrangements to support localities. However, funding benefits will be from network charges from other customers, and therefore any mandated arrangements need to be set up in a fair and transparent manner. The overall proposition of energy services and the relative impact of infrastructure should be considered in the construction of the policy intervention on benefits.

In particular, the rollout of new transmission infrastructure will help to lower bills, as we connect more and more affordable clean generation such as offshore wind. As set out in the energy National Policy Statements, the starting assumption is for new lines to be overhead lines (OHL) which we support as this is significantly cheaper than alternatives, e.g. underground cables or subsea. We are very supportive of a Government led, national information campaign as recommended in the Winser report being established to inform customers and communities on the need for this infrastructure and associated benefits.

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

Ofgem is consulting on the rationale for this feature of energy bills. Energy costs different amounts to supply in different areas of the country. There are numerous reasons why this is not always passed on in a cost-reflective basis, however, there are a number of passthrough costs relating to cost reflectivity that do lead to regional differences.

Broadly, the perspective on the fairness of these differential charges is complex as local system costs are influenced not just by geography but also by local decisions, informed by, for example, community influence over local network decisions. Holistic and future-looking discussions are needed about the extent to which localised energy differences in the cost to supply energy are paid for. Careful consideration is required across a number of themes including fairness, efficiency, and whether there are benefits that come from simplification of existing arrangements.

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

The cost of energy is still far higher than it was pre-crisis and many households simply cannot afford their energy bills. The Government has made efforts to help income cover the costs of running a home through the Autumn Statement and we hope that through the Spring Budget the Government will help address inequalities in affordability.

Interventions from the Government need to support market incentives to address strategic weaknesses driving high bills. These include reducing our dependence on gas, improving the efficiency of housing stock which is the worst in Western Europe and inadequate support for vulnerable households. [3]

A substantially larger and wider-reaching, targeted discount on bills, much like an extended, increased and expanded Warm Home Discount (WHD), funded progressively through general taxation, is needed. This mechanism will go some way to addressing inequalities in affordability caused by the exposure of customers to high energy needs and costs. A commitment to housing energy efficiency improvements and demand reduction is vital to reduce this exposure.

The key principles of an enduring, targeted support mechanism are:

1. It should be funded progressively through general taxation, rather than the regressive option of funding it through bills;
2. It should be underpinned by improved data and data-sharing capable of targeting support based on household income data;
3. It should be delivered by suppliers, but eligibility must be determined by Government or a third party — suppliers must not become "arbiters"; and
4. It should be designed in a way that maintains the ability and incentive for customers to shop around in the market.
5. Such an approach should be built out from the existing WHD framework rather than developed from scratch as the need for support is urgent.

[3] Home Builders Federation (2023) Housing Horizons: New analysis shows true scale of how UK housing is falling behind international counterparts