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The Standardised Element of Standard Tariffs under the Retail Market Review

Consultation

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Publication date:	06/02/2012	**Team:**	Retail Markets
Response deadline:	02/04/2012	**Tel:**	020 7901 7000
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Overview:

This consultation outlines the methodology that may be used to set the standardised element of a standard tariff under Ofgem's Retail Market Review (RMR). Specifically, it outlines our proposed approach to setting each possible element that may be included in a fixed standing charge. It also presents two options for the treatment of regional cost differences in standard tariffs under the RMR.

The RMR aims to make it easier for consumers to choose the tariff that is right for them. The release of this consultation meets our December 2011 commitment to outline a proposed methodology in early 2012. We consider that the approaches outlined in this consultation document are an important step in the development of our thinking. If adopted, these proposals should help to enhance engagement and competition in the energy market as part of the wider RMR package of remedies.

We consider it is important to consult fully on the options presented within this consultation to allow stakeholders to present their views, including alternative approaches that would meet our objectives. Responses to this consultation are due by 02 April 2012.

Context

Ofgem's principal objective is to protect the interests of consumers, present and future.[1] The RMR represents Ofgem's initiative to enhance competition in the retail energy markets and make it work more effectively so that there are increased benefits to consumers.

In December 2011, we set out our proposals to improve tariff comparability and to strengthen the Probe remedies in the domestic market. Proposals on strengthening the probe remedies in the non-domestic market were published in a separate consultation on 23 Nov 2011.[2]

As part of our December consultation we asked stakeholders to comment on the elements that should be included in the standing charge and noted that, in early 2012, we would consult on the detailed methodology that would be used to set the standing charge and possible regional adjuster. This consultation fulfils that commitment.

Associated documents

All documents are available at www.ofgem.gov.uk

- The Retail Market Review: Domestic Proposals, December 2011, Reference: 166/11
- The Retail Market Review: Draft Impact Assessments for Domestic Proposals, Supplementary Appendices, November 2011, Reference: 116A/11
- The Retail Market Review – Non Domestic Proposals, November 2011, Reference: 157/11
- The Retail Market Review – Draft Impact Assessment for Non Domestic Proposals, November 2011, Reference: 157A/11
- Retail Market Review: Energy bills, annual statements and price rise notifications; advice on the use of layout and language. A Research Report For Ofgem, Lawes Consulting and Lawes Gadsby Semiotics, November 2011

[1] This includes the interests of consumers in the fulfilment by Ofgem, when carrying out its functions as designated regulatory authority for Great Britain, of the objectives set out in Article 40(a) to (h) of the Gas Directive and Article 36(a) to (h) of the Electricity Directive.
[2] This document is available at: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_non-domestic%20proposals_consultation.pdf

- Tariff Comparability Models, Volume 1 - Consumer qualitative research findings, Creative Research, October 2011
- Consumer reactions to varying tariff comparability models, Quantitative Research conducted for Ofgem, Ipsos MORI, 18 October 2011
- Ofgem's Retail Market Review – update and next steps (non-liquidity proposals), June 2011
- Ofgem's Retail Market Review – update and next steps (liquidity proposals), June 2011
- The Retail Market Review – Findings and Initial Proposals, March 2011, Reference: 34/11
- Ofgem Consumer First Panel, Year 3 2010/11, Findings From The Second Set Of Workshops, Opinion Leader, March 2011
- Customer Engagement with the Energy Market – Tracking Survey, Ipsos MORI, March 2011
- Vulnerable Customer Research, FDS International, March 2011
- Energy Supply Probe - Proposed Retail Market Remedies, August 2009, Reference: 99/09
- Ofgem Consumer First Panel, Research Findings from the Second Events – Billing Information and Price Metrics, March 2009
- Ofgem Consumer First Panel, Research findings from first event, January 2009
- Energy Supply Probe - Initial Findings Report, October 2008, Reference: 140/08

Contents

Executive Summary

In December 2011, we released a consultation document ('our December consultation') outlining a range of reforms associated with Ofgem's Retail Market Review (RMR). These reforms aim to enhance effective consumer engagement in the domestic retail energy market in Great Britain (GB) leading to increased and more effective competition.

In that consultation we set out our proposals to improve tariff comparability and strengthen the probe remedies in the domestic market. As part of this we noted:

- all standard tariffs would be structured to consist of a compulsory regional standing charge plus a national unit rate set by suppliers (day / night rates for Economy 7 (E7) tariffs);
- Ofgem would set the compulsory regional standing charge, and possibly a regional adjuster to the unit rate to account for regional differences in network costs that vary with consumption;[3] and
- we would consult on the detailed methodology that would be use to set the standing charge and possible regional adjuster in early 2012.

We have since given further consideration to the indicative methodology (as outlined in our December consultation) for setting the standardised element of standard tariffs.

Our proposed methodology has changed since December primarily because of the proposed treatment of charges incurred by suppliers for the use of the transmission and distribution (T&D) systems. In December 2011, we considered that the majority of T&D charges could be expected to be fixed and therefore proposed that these costs would be recovered through the standing charge. We considered this appropriate because these costs are based on historical consumption (which is fixed) and would not be influenced by a consumer's energy use during the current year.

Having undertaken further work on the mechanics of T&D charges, we now consider that it is appropriate for the majority of T&D charges to be recovered through the unit rate. This is appropriate because the vast majority of T&D charges incurred by suppliers will typically be lower for customers that use relatively little energy than for those that use a lot of energy.

We consider that our revised proposal better balances the concerns of tariff comparability, cost reflectivity for suppliers, methodological transparency and minimisation of cross-subsidies between consumers than did our earlier proposal.

There are a number of other costs that do not vary by consumption (i.e. they are 'fixed') and which could be included in a standing charge. Whether these costs are included would depend on whether a narrow or wide standing charge is adopted (a decision being consulted on in our December consultation). Under a wide standing charge, in addition to the costs incurred for a small element of electricity distribution

[3] The Ofgem-set standing charge and possible regional adjuster are collectively referred to as the 'standardised element'.

costs, other costs may be considered. These other costs might include the costs of government environmental and social programmes, metering costs and other supplier fixed costs.

Given that there will always be some uncertainty over the exact level of fixed costs faced by suppliers we do not propose that the standing charge would be set simply by summing the estimated cost of the included elements. Rather, we would use the estimated cost of each element included in the standing charge as part of a broader assessment of the appropriate level at which to set the standing charge.

Our proposed treatment of suppliers' costs is summarised in the table below.

	Illustrative annual cost for average consumer (£)	Recovered through standing charge	Recovered through unit rate
Gas transmission	6	x	✓
Gas distribution	122	x	✓
Electricity transmission	19	x	✓
Electricity distribution	81	✓(£13)	✓(£68)
Energy Company Obligation*	29 (gas), 29 (elec)	✓	x
Warm Home Discount*	7 (gas), 7 (elec)	✓	x
Metering*[i]	23 (gas), 15 (elec)	✓	x
Other supplier fixed costs*	25 (gas), 25 (elec)	✓	x

** If included in the standing charge.*
i Metering cost estimates are based on traditional meters, not smart meters.

For each possible component of the standardised element presented in the table above, a detailed methodology for its treatment is presented in this document. We also present the following two options for the treatment of regional cost differences:

- **Option 1**: Ofgem sets a national standing charge and regional adjuster to the unit rate. Suppliers set a national unit rate.
- **Option 2**: Ofgem sets a national standing charge. Suppliers are able to set different unit rates in different regions to reflect cost differences.

Importantly, in both cases consumers would still be able to select the cheapest standard tariff simply by comparing the supplier-set unit rates. We are particularly keen to receive stakeholders' views on the benefits and drawbacks of each of these options.

In responses to this consultation, we would like stakeholders to comment on the methodology proposed for setting each possible part of the standardised element. We would also like stakeholders to comment on the pros and cons of each option on the treatment of regional cost differences, and to inform us of their preferred option.

1. Introduction

Chapter Summary

This chapter provides background on the tariff simplification proposals that were published in our December consultation document on the domestic market. It also outlines what we are consulting on as part of this consultation as well as the next steps in our RMR work programme.

Background

1.1. The RMR aims to empower consumers in GB to engage with the market by making information easier to access and understand. It also aims to simplify the structure of, and limit the number of, standard tariffs (those without a defined end date). These remedies should, as part of the package of RMR remedies, lead consumers to engage more effectively with the market and so lead to greater competition.

1.2. In our December consultation, we set out proposals to improve tariff comparability and strengthen the Energy Supply Probe remedies in the domestic market. Specifically, we set out an indicative approach to setting the standardised elements of standard tariffs. As part of this we proposed:

- all standard tariffs would be structured to consist of a compulsory regional standing charge plus a national unit rate set by suppliers (day / night rates for E7 tariffs);
- Ofgem would set the compulsory regional standing charge, and possibly a regional adjuster to the unit rate to account for regional differences in network costs that vary with consumption;[4] and
- we would consult on the detailed methodology that would be used to set the standing charge and possible regional adjuster in early 2012.

1.3. We noted that by setting the standing charge for standard tariffs and requiring standard tariffs to have a 'standing charge plus unit rate' structure, consumers would be able to select the cheapest standard tariff by simply comparing the supplier-set unit rate.

1.4. We also asked for stakeholders' views on whether the standing charge should be 'narrow' (and so be based on network charges alone) or 'wide' (and so include some other incremental costs of serving an additional customer). Potential elements of the standing charge are:

[4] The Ofgem-set standing charge and possible regional adjuster are collectively referred to as the 'standardised element'.

- networks charges;
- environmental obligations;
- Warm Home Discount; and
- metering and other fixed costs faced by suppliers.

1.5. We indicated that all potential elements of the standing charge, other than network costs, would be set at a national level and so would not differ between regions. We stated that regional differences in network charges would be accounted for by setting a separate standing charge for each region. We also stated that we may set a regional adjuster to the unit rate to account for differences between regions in the consumption-based cost of transmission and distribution (T&D).

This consultation

1.6. This consultation outlines a methodology that could be used to set the standardised element of a standard tariff under our RMR proposals. It asks specifically for views on the detailed methodology for each possible element that may be included in a fixed standing charge and on two options for the treatment of regional cost differences. This consultation fulfils our December 2011 commitment to consult on the methodology for setting the standardised element in early 2012. Importantly, we are not consulting on the scope of the standing charge as that question was included in our December consultation.

1.7. We recognise that the methodology outlined in this document has evolved since the publication of the indicative methodology outlined in our December consultation document. We also recognise that this may affect stakeholders' views on certain aspects of our December consultation.

1.8. In the December consultation we asked (question 2) "Which costs elements should be included in the standardised element of the standard tariffs?" Responses to the December consultation are due by 23 February 2012. However, given the scope of the issues discussed in this document, we would welcome any additional responses to this question as part of your response to this consultation.

Next steps

1.9. Interested parties are requested to provide views on the methodologies set out in this document before the closing date of this consultation on 02 April 2012. We would especially welcome views on the specific questions set out in Chapter 2 as well as the equations (see Appendices 1 and 2) that we are proposing to use as part of our proposed methodology. Details of how to respond can be found in Appendix 3.

1.10. Following consideration of responses to this document (and responses to our December consultation), we intend to publish a decision document and final impact assessment on our proposals to improve tariff comparability and strengthen the probe remedies in the domestic market.

2. Proposed methodology

Chapter Summary

In this chapter we outline a proposed methodology for setting the standing charge for standard tariffs under the RMR. We outline how our thinking has developed and present two options for the treatment of regional cost differences. We also provide information on how these options could be captured through the licence conditions.

Question 1: Do stakeholders agree with our proposed approach to those costs that should be recovered through a standing charge and those costs that should be recovered through a unit rate?

Question 2: Do stakeholders have any comments on the proposed broad assessment of the possible elements of the standing charge (set out in Appendix 1)?

Question 3: Do stakeholders have any comments on the treatment of regional cost differences? Do they favour Option 1 or Option 2?

Question 4: Do stakeholders have any comments on the assessment of the individual elements of the possible regional adjuster (set out in Appendix 2)?

Question 5: Do stakeholders agree with our proposed treatment of the standing charge (based on a broad assessment) and possible regional adjuster (using a formulaic approach) in the licence conditions?

Question 6: Do stakeholders agree with the proposed timing of any potential changes to the standing charge and possible regional adjuster?

2.1. In our December consultation, we proposed that Ofgem would set a regional standing charge, and possibly a regional adjuster to the unit rate, for standard tariffs. Combined with our proposal to require standard tariffs to have a 'standing charge plus unit rate' structure, this would allow consumers to select the cheapest standard tariff available by comparing only the unit rate set by suppliers.

2.2. Our thinking on the best approach for setting a standardised element of standard tariffs has developed since December. In particular, we have reviewed our treatment of network costs and have developed two new approaches that could be used to calculate the standardised elements of standard tariffs.

2.3. In this chapter we outline how our thinking has evolved. This includes:

- developments in our thinking on network charges;
- our proposals for allowing suppliers to recover their costs;
- how we propose accounting for regional cost differences;
- our proposed treatment in the licence condition; and
- timing.

2.4. This chapter has been written in a non-technical manner. A more technical discussion on these issues is presented in Appendices 1 and 2.

What has changed since our December RMR proposals?

December RMR – recovering network costs in the standing charge

2.5. In our December consultation document we provided estimates of T&D costs incurred by suppliers based on an indicative methodology for setting the standing charge. That methodology treated the majority of T&D charges as fixed because we considered that these costs could not be influenced by a consumer's energy use during the current year. Based on that, our indicative methodology suggested that network costs would be recovered through the standing charge.

2.6. Since December we have reviewed our approach to setting the standardised element. We now appreciate that the vast majority of T&D charges are based either on current or historical consumption and that for the majority of domestic consumers there will be a close correlation between current and historical consumption. This means that the network costs incurred by suppliers will typically be lower for those that use relatively little energy than for high users.

New approach – recovering network costs through the unit rate

2.7. Given the correlation between the network costs incurred by suppliers and energy consumption, we now consider it would be appropriate for the majority of T&D charges to be recovered through the unit rate. This would ensure that suppliers recover costs in the same way that they are incurred and so is more cost reflective than the indicative approach outlined in December.

2.8. The only network charge that is not affected by consumption is a small element of electricity distribution charges – the Distribution Use of System (DUoS) fixed charge.

How will suppliers recover their other costs?

2.9. Under this new approach, all variable network costs would be recovered through the unit rate rather than the standing charge.

2.10. With respect to other fixed costs that may fall within the scope of the standardised element, under our proposed approach these would be recovered through the standing charge. If we were to adopt the widest definition of the standing charge (which we are currently consulting on through our December consultation) these fixed costs would comprise the Energy Company Obligation, the Warm Home Discount, metering, the fixed network cost that is associated with electricity distribution, and other supplier fixed costs.

2.11. Our proposed treatment of suppliers' costs is summarised in Table 2.1.

Table 2.1: Treatment of suppliers' costs

	Illustrative annual cost for average consumer (£)	Recovered through standing charge	Recovered through unit rate
Gas transmission	6	x	✓
Gas distribution	122	x	✓
Electricity transmission	19	x	✓
Electricity distribution	81	✓(£13)	✓(£68)
Energy Company Obligation*	29 (gas), 29 (elec)	✓	x
Warm Home Discount*	7 (gas), 7 (elec)	✓	x
Metering*[i]	23 (gas), 15 (elec)	✓	x
Other supplier fixed costs*	25 (gas), 25 (elec)	✓	x

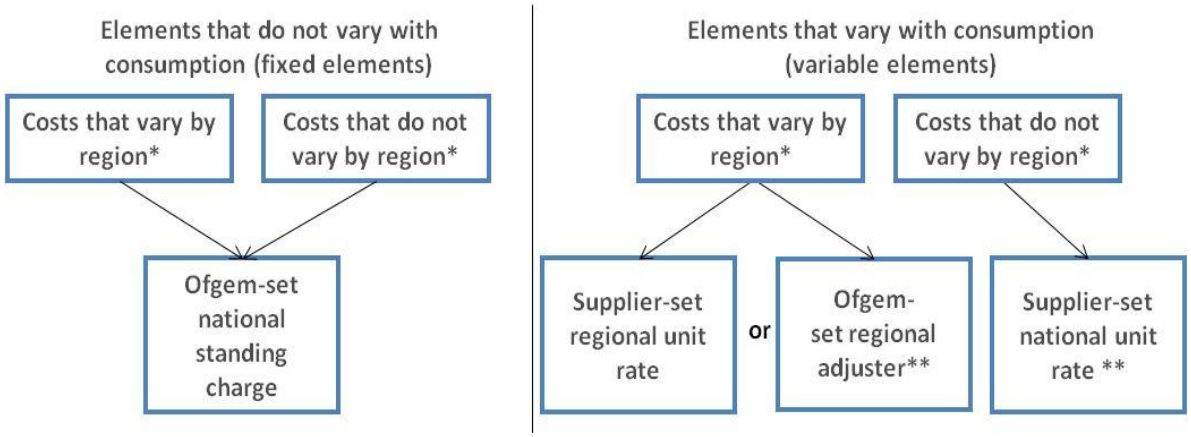
** If included in the standing charge.*
i Metering cost estimates are based on traditional meters, not smart meters.

2.12. Given that there will always be some uncertainty over the exact level of fixed costs faced by suppliers we do not propose that the standing charge would be set simply by summing the estimated cost of the included elements. Rather, we would use the estimated cost of each element included in the standing charge as part of a broader assessment of the appropriate level at which to set the standing charge. This point and the methodology for each possible element that may be included in a fixed standing charge are discussed further in Appendix 1.

Accounting for regional differences

2.13. Figure 2.1 summarises how regional cost differences could be accounted for, given the treatment of suppliers' costs outlined above.

Figure 2.1: Treatment of regional differences



**Of the fixed elements considered, only metering and the DUoS fixed rate vary by region. Regional cost differences in these elements are likely to be relatively low and metering costs would vary between suppliers. To ensure simplicity for consumers we propose to set a national standing charge.*
***If Ofgem were to set a regional adjuster to the unit rate, suppliers would set a national unit rate.*

2.14. One important factor that we considered when deciding how to account for regional cost differences is the extent to which tariffs are able to reflect these differences while at the same time ensuring our proposals are easy for consumers to understand. Our thinking has led us to propose a national standing charge and to allow unit rates to differ between regions. The reasons for this are explained in subsequent paragraphs.

Accounting for regional differences - standing charge

2.15. We have considered the extent to which potential components of the standing charge differ between regions. The cost of Energy Company Obligations (ECO) and the Warm Home Discount would not vary between regions. The DUoS fixed charge differs between regions but the monetary value of these differences is relatively small. Metering costs and suppliers' other fixed costs may vary between regions, but the pattern is likely to differ across suppliers.

2.16. We therefore consider that the standing charge should be the same for all regions. This is because:

- there is relatively limited regional variation in the potential elements of the standing charge;
- those elements that do vary have a relatively low impact on bills; and
- we are proposing that the standing charge would not be based directly on the costs of each potential element of the charge but these would feed into a broad assessment of suppliers' fixed costs.

Accounting for regional differences - unit rates

2.17. The cost to suppliers for using the gas and electricity networks varies between regions. These arrangements have been in place since before liberalisation of the energy market and reflect the different costs associated with serving different parts of GB. They also reflect differences in the performance of the regional network companies.

2.18. The differences in network charges are reflected, to some extent in energy prices today. Our analysis suggests that for an average customer that uses both gas and electricity, the price difference between the cheapest and most expensive regions is approximately £55 at present.

2.19. This is an issue we need to consider in the context of our RMR proposals and are therefore consulting on two options for the treatment of regional differences under our RMR proposals. Requiring suppliers to offer both a national unit rate and a national standing charge would require cross-subsidies between regions and would make some consumers (i.e. those located in regions with low network costs) more valuable to suppliers than others. This could have a potentially damaging effect on competition in some regions.

Options for consultation

2.20. Based on the above discussion, we have developed the following two options for the treatment of regional cost differences for standard tariffs:[5]

- **Option 1**: Ofgem sets a national standing charge and regional adjuster to the unit rate. Suppliers set a national unit rate.
- **Option 2**: Ofgem sets a national standing charge. Suppliers are able to set different unit rates in different regions to reflect cost differences.

2.21. Table 2.2 summarises the key components of the above two options, and how they compare to the December RMR proposal.

Table 2.2: Standardised element – key differences between December and January proposals

Proposal	Ofgem-set standing charge	Unit rate		Recovery of network costs
		Geography	Is there a regional adjuster?	
December consultation	✓	National	?	Standing charge
January consultation - Option 1	✓	National	✓	Unit rate*
January consultation - Option 2	✓	Regional	x	Unit rate*

** except DUoS fixed charge*

2.22. Each option has different benefits and drawbacks, as summarised in Table 2.3. Under Option 1, suppliers would set a national unit rate. This would be comparable across the country and would make it easier to hold national switching campaigns. The regional adjuster would ensure that regional differences are cost reflective but it may have an impact on the charges that consumers in different regions pay for their energy. Our analysis suggests that, for an average consumer of gas and electricity, the cost difference between the cheapest and most expensive region could rise from approximately £55 to approximately £90 (although we would need to consider the extent to which a decision on the level of any regional adjuster was based solely on these costs).

2.23. Under Option 2, suppliers would be able to set regional unit rates, so they would continue to make decisions over the prices they charge in different regions. There would only be two parts to tariffs which might make bills easier to calculate for consumers. However, the benefits that would arise from suppliers national unit rates

[5] A detailed discussion of the methodology that would be used to set the standing charge under either option is in Appendix 1. The methodology that would be used to set the regional adjuster under Option 1 is in Appendix 2.

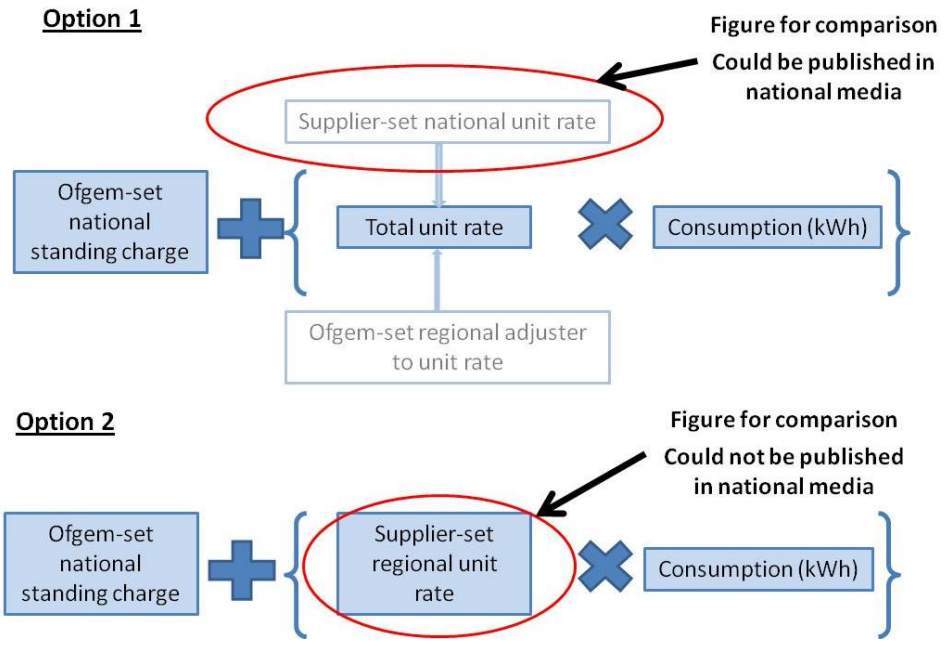
would not be realised. It is likely that it would be more difficult to calculate the price comparison guide. We are interested in stakeholders' views on these options.

Table 2.3: Benefits and drawbacks of the January proposals

Option	Benefits	Drawbacks
1	Regional differences are cost reflective Regional differences are transparent Allows communication of supplier-set unit rates in a wide range of national media Easy for consumers to compare the supplier-set national unit rates	More complex: three elements of standard tariffs need to be considered More interventionist approach Will cause distributional impacts
2	Less interventionist approach Simpler – only two tariff elements need to be considered	May be difficult for tariff information to be published on a national basis Consumers may have difficulty in understanding which supplier-set unit rates are applicable (i.e. they may not know which region they are located in) Greater risk of cross-subsidies between regions

2.24. Figure 2.2 shows how customer bills would be calculated for standard tariffs – but not how they would be presented – under each option (noting that the standardised element discussed above would not apply to non-standard tariffs). It also demonstrates that the consumer would, in line with our previous proposals, only need to compare a single supplier-set unit rate under each option to select the cheapest standard tariff.

Figure 2.2: Tariff comparability and bill calculation under each option



2.25. We recognise that there could be alternative approaches to, or indeed variants of, the two options described above. One such variant of Option 1 would be to apply the regional adjuster to the standing charge rather than the unit rate. Alternative approaches or variants are not detailed further in this document but we would welcome any views that stakeholders may have on these.

Treatment within licence conditions

Standing charge

2.26. We consider that the most appropriate approach to incorporating the standing charge into licences is to include a schedule of standing charges, with an automatic adjuster for subsequent years.

2.27. The key reason that we are proposing an Ofgem-set standing charge is to simplify the structure of standard tariffs. This should make it easier for consumers to understand their tariff options and select the cheapest standard tariff. While we would like the standing charge to be broadly cost reflective, we do not want it to be spuriously accurate, and do not want to introduce complexity where it is not needed.

2.28. Our proposed approach is pragmatic and we consider it to be appropriate because the expected costs of the various components we may include in an Ofgem-set standing charge are unlikely to vary substantially from year to year. This applies irrespective of whether we use a narrowly or widely defined standing charge, as illustrated in Table 2.4. We therefore consider that it would be possible to estimate the level of costs that suppliers may encounter in the future with a reasonable degree of accuracy and outline these in a schedule.

2.29. We consider that this approach would provide some certainty to suppliers regarding the future level of the standing charge. However, Ofgem would monitor actual costs incurred by suppliers and may propose a change to the licence if observed costs were found to differ significantly from those anticipated.

Table 2.4: Standing charge (Option 1 and Option 2)

Standing charge component (costs that are independent of consumption)	Expected variability	Proposed treatment in licence
Electricity distribution (Approx. £13)	**High** in some years, **low** in others	Schedule of numbers for early years + automatic adjuster thereafter
ECO (Approx. £29 per fuel per annum[6])	**Low**	
Warm Home Discount (Approx. £7 per fuel for 2011/12[7])	**Unknown (probably low)** Set by Secretary of State	
Metering* (Approx. £25 gas, £13 electricity)	**Unknown**	
Suppliers' other fixed costs	**Low**	

** Metering cost estimates are based on traditional meters, not smart meters.*

Possible regional adjuster

2.30. Table 2.5 shows that the greatest costs associated with the standardised element are those that would be included in the possible regional adjuster.[8] These costs are also the most likely to vary significantly from one year to the next. Therefore, we propose to include formulae in the licence conditions for the regional adjuster under Option 1. This would mean that any change in network charges would be fully reflected in the regional adjuster.

2.31. Our position on this issue was reached following an assessment of the likely variability of the various cost elements, the likely monetary impact of any variability on consumers and the need for our proposals to generate an environment of regulatory certainty.

[6] Based on DECC (2011), 'The Green Deal and Energy Company Obligation Impact Assessment', page 291.
[7] Based on DECC (2011), 'The Warm Home Discount Scheme Impact Assessment', page 4. Estimated annual scheme cost of £324m apportioned across customer accounts.
[8] Note that the network charges cost estimates reported in the tables are based only on those costs that would be included in the standing charge or possible regional adjuster. The figures do not show the total costs of transmission or distribution.

Table 2.5: Regional adjuster (under Option 1 only)

Regional adjuster component (costs that vary with consumption)	Expected variability	Proposed treatment in licence
Gas transmission (Approx. £6 for average user in 2011/12)	**Low/Medium** (average change of £0.26 or 2.4% per annum over past 5 years)	Formulae
Gas distribution (Approx. £122 for average user in 2011/12)	**Low/Medium** (average change of £4.53 or 4.5% per annum over past 5 years)	
Electricity transmission (Approx. £19 for average user in 2011/12)	**Medium** (average change of £1.32 or 9% per annum over past 5 years)	
Electricity distribution (Approx. £68 for average user in 2011/12)	**High** in some years, **low** in others	

Consumer engagement and distributional issues

2.32. Recovering network costs through the unit rate would help to protect low energy users as it would reduce the level of the standing charge and so should limit the difference in cost per unit between low and high users. Low energy consumers are more likely to be low income[9] and so our revised proposals could help many of those with low incomes.

2.33. In considering the methodology for setting each possible part of the standardised element we need to be mindful of how information will be presented to and used by consumers. The different approaches would have different implications for consumer engagement and for establishing the price comparison guide.[10] We will consider how this information is used and presented as part of our ongoing policy development, where appropriate using research. We recognise that a more complex methodology for calculating the standardised element need not result in complex presentation for consumers.

2.34. In setting the methodology and scope of the standardised element we will also be mindful of the potential distributional impacts on consumers. We intend to explore the impact of different levels of standing charges and possible regional adjusters on different types of consumers. This work would consider the potential impact of different levels of standing charge relative to different levels of income and energy consumption. It would also assess the impact of the tariff structures illustrated in Figure 2.2 on different types of consumers.

[9] Centre for Sustainable Energy (2010), 'Understanding 'High use low income' consumers', Page 7, Figure 2.
[10] The price comparison guide is described in our December consultation document.

Timing

2.35. Given that the level of the standing charge can be estimated for several years into the future, monetary values would be hard-coded into licence conditions. We consider that this means that there would be some flexibility concerning the date on which the standing charge could be amended.

2.36. Revised network charges, which would have a direct impact on the regional adjuster under Option 1, typically enter into force on 1 April each year.[11] Ideally we would amend the level of the standing charge and any regional adjuster on 1 April in line with any changes to network charges. This would help consumers to better understand any price changes on their bills and when they have occurred.

2.37. However, this is unlikely to be feasible under Option 1. Suppliers would be required to give consumers at least 30 days notice of any change in the level of the standing charge and regional adjuster. Given that electricity distribution charges are finalised only 40 days prior to entering into force on 1 April we consider that any change in the level of the regional adjuster would need to lag changes in network costs.[12]

2.38. While a lag is not ideal, it would not mark any change from the way suppliers currently reflect changes in network costs in customer bills. While network charges typically change on 1 April, suppliers tend to increase prices later in the year. Therefore, we do not consider that a lag in amending the standing charge and any regional adjuster would have an adverse impact on suppliers.

2.39. We have considered the appropriate length of time that suppliers should have to amend the standing charge and any regional adjuster. We propose that, under Option 1, suppliers would be required to amend the standing charge and regional adjuster on 1 June each year. We consider that this timing is appropriate as it would give suppliers sufficient time to notify their customers of the change in the standing charge / regional adjuster and to comply with the 30-day rule for advanced notice of price increases.

2.40. Under Option 2, suppliers would set a regional unit rate and so would need to account for changes in network charges when revising their unit rates. This means that the same timing issues would apply under this option, but would be faced by suppliers rather than Ofgem. While there is some flexibility concerning the date on which standing charges could be amended, we consider that it would benefit consumers to give suppliers the opportunity to limit the number of times their prices

[11] Mid year changes to network charges are possible. However, other than for electricity distribution mid year changes are infrequent. In 2010, only two DNOs made mid-year changes to electricity distribution charges but the changes have been up to 10 per cent in the past.
[12] We propose to change network charges only once each year. However, Ofgem would monitor actual costs incurred by suppliers and may propose a change if we observe significant mid-year changes to network costs.

change during any given year. Therefore, we propose that the standing charge would be amended annually on 1 June each year under Option 2 as this would allow suppliers sufficient time to take account of changes in network charges and so would give them the opportunity to amend their regional unit rates on the same date.

Appendices

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Appendix 1 – Standing charge

1.1. This appendix is divided into four sections. Each section explores the methodology behind the four possible cost elements that we may use to inform the level at which the standing charge may be set. The four possible elements are network charges, environmental obligations, Warm Home Discount and metering and other costs.

1.2. Importantly, we do not make a firm proposal anywhere in this appendix (or anywhere within this consultation) on whether to adopt a narrow or wide standing charge definition. A 'narrow' definition of a standing charge would include only T&D costs while a 'wide' definition includes both those costs and one or more of the other cost categories noted in the previous paragraph. The issue of whether to apply a 'narrow' or 'wide' definition for the standing charge is being considered as part of our December consultation and we do not have a minded to position on this issue at this time.

Network charges

Overview

1.3. Energy suppliers incur costs associated with using the gas and electricity T&D networks. Some of these are based on the number of customers served by a supplier while others are based on the amount of energy supplied. Importantly, the level of some of these charges differs across regions while others are the same across GB.

1.4. The methodology we outline below for T&D charges is equally applicable to whether a 'narrow' or 'wide' definition of the standing charge is chosen. That is, network charges are likely to be included in any definition that we use.

Gas

1.5. In our December consultation we treated gas T&D costs as fixed, the rationale being that the level of consumption in the current year does not affect the cost incurred by the supplier. As such, we proposed that these costs would be included in the standing charge. Under this approach suppliers would recover the same amount from each consumer, irrespective of consumption.

1.6. Having re-considered this issue, we now believe that this approach is not consistent with the way in which gas T&D costs are incurred by suppliers. Suppliers' costs of gas T&D do not depend on customers' consumption in the current year but are based on their consumption during the previous year. Hence, the cost to suppliers would be higher for those customers that used a large amount of gas in the previous year and lower for those that used a relatively small amount.

1.7. Given that there will be a close correlation between use in the current and previous year for the majority of domestic consumers, we now consider that gas T&D costs should be recovered through the unit rate. The two potential approaches to the unit rate are described in Chapter 2, with the proposed approach to setting a possible regional adjuster described in Appendix 2.

Electricity

1.8. Our proposed approach to electricity distribution costs remains consistent with the approach outlined in our December consultation. In that consultation we proposed that the fixed element of electricity distribution would be recovered through the standing charge while the variable element would be recovered through the unit rate.

1.9. It is worth noting that there is some regional variation in the DUoS charges that would be incurred by suppliers. Importantly, the regional variation in the fixed element of these costs is quite limited[13] and as a result we consider that it would be appropriate to include this cost element as part of a national standing charge. This approach would ensure that the simple structure of standard tariffs is preserved and so would reduce one of the barriers to consumers engaging with the retail energy market.

1.10. Our approach to electricity transmission costs has changed since December. In our December consultation, electricity transmission costs were treated as a fixed cost. However, we have since determined that the cost to each supplier for transmission is calculated monthly based on the supplier's forecast for what they consider consumers will use at peak time (4pm–7pm). This forecast is reconciled to actual peak consumption initially one month after year end and again 14 months later.

1.11. We now consider that recovery of this cost is best achieved through the unit rate as this will allow suppliers to recover the amount that they will pay in Transmission Network Use of System (TNUoS) charges following reconciliation of forecast peak consumption with actual peak consumption. The two potential approaches to the unit rate are described in Chapter 2, with the proposed approach to setting a possible regional adjuster described in Appendix 2.

Impact on standardised element

1.12. Under our revised approach, the proposed treatment of network charges is summarised in Table A1.1.

[13] Our assessment of fixed network costs would be based on the customer-weighted average annual DUoS fixed cost. Also note that the regional DUoS fixed charge is the same for consumers with single rate and E7 meters.

Table A1.1: Treatment of network charges

Charges recovered through the standing charge (fixed charges)	Electricity	DUoS fixed rate
	Gas	N/A
Charges that may warrant consideration in the unit rate	Electricity	DUoS unit rate TNUoS
	Gas	Local Distribution Zone (LDZ) capacity Customer capacity Customer commodity National Transmission System (NTS) exit capacity

1.13. The above table illustrates that under our proposed approach, if network charges were the only element of a standing charge (as would occur under a narrowly defined standing charge), there would be a standing charge for electricity but not for gas.

1.14. Network charges are not, however, the only costs that we may need to consider in the setting of a standing charge for a standard tariff under our RMR proposals. While the methodologies that could be used for these other costs are explored below, it is important to note that a decision on whether the standing charge should be narrowly or widely defined has yet to be made.

Environmental obligations

1.15. Under a widely defined standing charge, we may need to consider the cost to suppliers of meeting those environmental obligations that are allocated to suppliers on the basis of their market share.

1.16. The Department of Energy and Climate Change (DECC) has recently developed the Green Deal and the Energy Company Obligation (ECO). The Green Deal is a new policy initiative while ECO will replace the current Carbon Emissions Trading Target (CERT) and the Community Energy Saving Programme (CESP).[14] Both schemes will begin formally in October 2012.

Green Deal

1.17. The Green Deal will enable consumers to finance and procure energy efficiency measures for their homes. To qualify for the Green Deal, the cost of installing the energy efficiency measures must be less than or equal to the expected savings in fuel bills (Green Deal's Golden Rule).

[14] Full details of DECC's proposals can be found in DECC (2011), 'The Green Deal and Energy Company Obligation Consultation Document'.

1.18. Consumers participating in the Green Deal will then repay the cost of their finance through their energy bills. Suppliers will incur Green Deal administration costs but will be able to recover some of these through administration charges.

1.19. We do not propose to set a specific element of the standing charge based on the remaining Green Deal administration costs. The scale of these costs is unknown at present because the likely level of administration charges is not known. In any case, we consider that such costs would, if included within a standing charge, fall within the category of supplier overheads. This may fall into the scope of the 'metering and suppliers' other fixed costs' section of this appendix.

ECO

1.20. ECO will be a subsidy to the consumer to help them reduce their carbon emissions and reduce heating costs by installing energy efficiency measures. The full cost of delivering measures under ECO will be met by the supplier. We expect that suppliers will pass these costs on to consumers.

1.21. There are two 10 year obligations within ECO: Carbon Saving and Affordable Warmth:[15]

- The Carbon Saving obligation will help consumers in hard-to-treat homes where the cost of installing measures such as Solid Wall Insulation outweighs the expected energy bill saving (thereby helping these consumers meet Green Deal's Golden Rule).
- The Affordable Warmth obligation will subsidise the installation of energy efficiency measures in low income households who are at risk of ill health caused by living in poorly heated homes.

1.22. The key features of ECO are summarised in Table A1.2.

Table A1.2: Key features of ECO

Obligation	Percentage of ECO cost	Statutory targets 2012-2015	Target customer group
Carbon Saving	75	Reduction in CO_2 emissions – 0.52m tonnes per annum	Hard-to-treat homes
Affordable Warmth	25	Reduction in lifetime costs of heating - £3.4 bn	Vulnerable households, incl. elderly, disabled, low-income

1.23. It is worth noting that:

[15] DECC is not proposing that the obligations will be mutually exclusive. A low income household in a hard-to-treat home could be eligible for assistance through the Carbon Saving obligation. DECC is consulting on whether it should set a 'distributional safeguard' to ensure a minimum proportion of the Carbon Saving obligation is provided to low-income households.

- only domestic energy suppliers with more than 250,000 customers will be required to participate in ECO – domestic suppliers with fewer customers may choose to participate in the scheme; and
- the method of determining supplier obligations is not yet confirmed – DECC's current proposal is that a supplier's market share will determine its individual obligation but it is consulting on whether an approach based on the amount of energy consumed by a supplier's customers would be more appropriate.

ECO and the standing charge

1.24. As ECO obligations are not expressed in specific monetary amounts (rather, as per the table above, they are expressed in terms of heating cost reduction and carbon savings), the total cost of ECO to suppliers cannot be known in advance. However, DECC's analysis suggests that energy suppliers will pass through costs of approximately £1.3bn per year between 2012 and 2015.

1.25. If DECC maintains its proposal to allocate supplier obligations on the basis of market share we consider that this would give a signal to suppliers to pass the costs of ECO compliance onto their customers on a per-customer basis. As a result the costs associated with ECO may fall within the scope of a wide standing charge (depending on how the standing charge is defined).[16]

1.26. The formula below would be used to help us estimate the per-customer cost of ECO, if it were to be included in the standing charge.[17] In this case, the estimated cost would feed into our determination of the appropriate level to set the standing charge for a standard tariff under our RMR proposals.

$$\text{Cost of ECO per account} = \frac{\text{DECC's estimated annualised pass through cost of ECO}}{\text{Total number of all ECO suppliers' gas and electricity accounts}}$$

1.27. Notwithstanding that this formula would only be used to assist us in determining the appropriate level to set the standing charge, we would monitor the costs incurred by suppliers in meeting their ECO obligations. We would factor any significant difference between actual costs and those estimated by DECC into our broad assessment of the level at which the standing charge should be set.

1.28. We recognise that small suppliers may not incur ECO costs but propose to apply the same standing charge for all suppliers. This is essential if we wish to enable consumers to select the cheapest standard tariff simply by comparing the unit rates offered by different suppliers.

[16] If DECC chooses to allocate ECO obligations on the basis of consumption, we would not expect it to fall into the scope of the standing charge.
[17] For the purpose of this calculation, a customer that uses both gas and electricity would be treated as having two accounts.

1.29. However, this means that the standing charge may be higher than the costs incurred by small suppliers, if the cost of ECO is included in the national standing charge. However, small suppliers may face a higher average cost of serving a typical consumer because they are unable to benefit from economies of scale.

1.30. The desire to avoid placing disproportionate burdens on small suppliers is one reason that DECC has proposed applying a 250,000 customer threshold for ECO obligations. In this context, setting the same standing charge for all suppliers would allow small suppliers to recover their higher average fixed costs and so would not discriminate against them.

Warm Home Discount

1.31. The Energy Act 2010 provides the Secretary of State for Energy and Climate Change with powers to make regulations to reduce fuel poverty. From these regulations, DECC developed the Warm Home Discount (WHD), which became operational on 1 April 2011.[18]

1.32. Through the WHD initiative, energy suppliers will provide up to £1.13bn in direct and indirect support to fuel-poor consumers between 2011 and 2015. The main features of each of the four strands of WHD are summarised in Table A1.3.

Table A1.3: Key features of WHD

	WHD Strand			
	Core Group	**Broader Group**	**Legacy Spend**	**Industry Initiatives**
Key features	Fixed annual rebate to fuel poor consumers DECC identifies fuel poor consumers	Fixed annual rebate to fuel poor consumers Suppliers determine eligibility criteria. Ofgem approves criteria if within WHD parameters	Continuation of financial support to previous Voluntary Agreement[19] consumers	Additional supplier-funded programmes and partnerships to assist those consumers in, or at risk of, fuel poverty

1.33. Energy suppliers' obligations under WHD are determined as follows:

- *Customer numbers*: licensed electricity suppliers with more than 250,000 customers in the previous WHD scheme year are obliged to participate in WHD's Core Group and Broader Group. Licensed electricity suppliers with fewer than

[18] See Ofgem E-Serve (2011), 'Warm Home Discount: Guidance for Licensed Electricity Suppliers and Licensed Gas Suppliers' for a detailed description of WHD.
[19] The Voluntary Agreement between the Government and energy suppliers provided financial support and other benefits to fuel-poor consumers. It was replaced by WHD on 1 April 2011.

250,000 customers in the previous scheme year can choose whether to participate in WHD's Core Group.

- *Market share*: Ofgem determines each participating energy supplier's obligation using its market share. Its market share is applied separately to total Core and total non-Core spending for that Scheme year, as set out by the Secretary of State.[20]

WHD and the standing charge

1.34. As WHD obligations are determined on the basis of market share, a supplier would incur the same increase in WHD costs for each additional customer, irrespective of that customer's energy use. As per the discussion on ECO, we consider that there may be merit in such a cost being recovered through a standing charge (which would be the same for all customers on a given tariff) rather than through a consumption based cost.

1.35. The formula below would be used to help us estimate the per-customer cost of the WHD, if it were to be included in the standing charge.[21] This cost would feed into our determination of the appropriate level to set the standing charge for a standard tariff under our RMR proposals.

$$\text{Cost of WHD per account} = \frac{\text{Total WHD budget in Scheme year}}{\text{Total number of all WHD suppliers' gas and electricity accounts}}$$

1.36. We recognise that small suppliers may not incur WHD costs but that they would face the same standing charge as large suppliers if this cost is used as part of the process to determine the appropriate size of a national standing charge. However, as per the situation with ECO, setting the same standing charge for all suppliers would allow small suppliers to recover their higher average fixed costs and so would not discriminate against certain suppliers. This would also allow consumers to select the cheapest standard tariff simply by comparing the supplier-set unit rate.

Metering and suppliers' other fixed costs

1.37. The final category of costs that it may be appropriate to consider in setting the standing charge for a standard tariff is metering and suppliers' other fixed costs. The discussion of metering costs in this appendix, and the cost estimates presented in the main document, are based on current practice and traditional (not smart)

[20] Ofgem calculates Core market share only in Year 1, but calculates non-Core market share in Years 1-4. For a full explanation, see Ofgem E-Serve (2011), 'Warm Home Discount: Guidance for Licensed Electricity Suppliers and Licensed Gas Suppliers', p.11.

[21] For the purpose of this calculation, a customer that uses both gas and electricity would be treated as having two accounts.

meters. We will continue to consider the implications of our proposals in the context of the smart meter roll-out.

1.38. There are approximately 26m electricity meters and 22m gas meters in GB. Metering costs account for around two per cent of a typical gas bill and around one per cent of a typical electricity bill at present. A description of the metering costs incurred by suppliers, and how they may be accounted for in the standing charge, is provided below.

1.39. In December 2011, we published a document to conclude our Review of Metering Arrangements (ROMA).[22] This reviewed various aspects of how the current regulatory framework for traditional metering operates and considered whether this operates in the interests of consumers. We concluded that many aspects of current arrangements are fit-for-purpose and should not be changed.

1.40. The December ROMA document recognised that there may be changes to traditional metering costs as a result of the implementation of smart meters (e.g. as a result of decreasing economies of scale in serving a reducing meter stock). We also recognised that the existing gas metering tariffs had been implemented in 2002 and therefore may no longer be set at the correct level. This may be because of changes in costs or increasing efficiencies. In the light of this we are currently consulting on a range of options to promote efficiency in managing the decline of traditional meters consequent to smart meter roll-out. In particular we are considering changes to the obligations on Gas Distribution Networks (GDNs) and reviewing review of the associated framework of price regulation. The ROMA consultation closes on 23 March 2012. Responses to that consultation will be considered alongside work on the standing charge proposals.

1.41. There is scope to consider some other fixed costs that suppliers may bear in supplying energy to their customers. Our approach to these costs is described at the end of this section.

Gas meters

1.42. Currently, regulated price caps are in place for both Domestic Credit Meters and Pre-Payment Meters owned by GDNs. For these 'legacy meters', GDNs are not able to charge customers above the level of the price cap for metering services. Meters that are procured by commercial meter operators are done so on a competitive basis but determining a 'typical competitive cost' for all suppliers would be disproportionately resource intensive.

[22] See: www.ofgem.gov.uk/Markets/sm/metering/tftm/roma/Documents1/ROMA%20Final%20Decision.pdf

1.43. Therefore, we consider that the costs of metering a typical gas customer should be based on the regulated price caps. This would feed into our assessment of the appropriate level at which to set the standing charge, were metering costs to be included.

Electricity meters

1.44. Following the introduction of competition in electricity metering, the meter market has been split in two – legacy and non-legacy. Legacy meters are those installed before 1 April 2007 and are regulated by a price cap. Non-legacy meters are open to full market competition.

1.45. Distribution Network Operators (DNOs) are required to publish their legacy meter charges and, were metering to be included in the standing charge, our assessment of metering costs would be based on these published prices. We would calculate the weighted average legacy meter charge based on the charges applied by each DNO, where the proportion of all electricity customers in each DNO would act as the weights. This would feed into our assessment of the appropriate level at which to set the standing charge.

Other fixed costs

1.46. We would consider the extent to which suppliers recover other fixed costs through the standing charge and would make an allowance for this.

1.47. Our estimates suggest that suppliers typically recover £20-£30 of other fixed costs through each fuel's standing charge at present. These estimates are based on a comparison of the typical standing charge levied by suppliers with the costs they currently bear for network charges, environmental obligations, metering and social obligations. We consider that the scale of suppliers' other fixed costs would not be affected by our proposals to change the structure of standard tariffs and so have used these figures as our estimate of future costs.

Appendix 2 – Possible regional adjuster

1.1. In GB there are regional differences in the network costs associated with transmitting and distributing gas and electricity. These costs tend to reflect the number of consumers in a region and the distance these consumers live from sources of energy generation. They also reflect differences in the performance of the regional network companies. These factors mean that for a given level of consumption, suppliers will incur higher network costs in some regions than in others.

1.2. We recognise that suppliers need to recover these costs and that cross-subsidies would be limited if they are able to recover these costs in the same way that they are incurred. This consultation is, in part, seeking views on the two ways in which this could be done.

1.3. Chapter 2 of this consultation outlined the two options for treating regional cost differences for standard tariffs under RMR. These are summarised in Table A2.1.

Table A2.1: Key components of the two options we are considering

Option	Ofgem-set standing charge	Supplier-set unit rate	Ofgem-set regional adjuster
1	✓	✓ (national)	✓
2	✓	✓ (regional)	x

1.4. This Appendix presents the methodology that would be used to set the regional adjuster under Option 1. We do not discuss Option 2 as suppliers would set all elements of the unit rate under that option.

How would a regional adjuster work?

1.5. Under Option 1, Ofgem would calculate the regional adjuster that would be applied to suppliers' unit rates.[23] The regional adjuster would be calculated separately for each fuel and would be based on the 'tariffs' published in network charging statements.[24] In summary, the regional adjuster would simply be the tariff in a given region minus the tariff in the cheapest region. For example, for region z, its regional adjuster would be:

Regional adjuster z $_{(p/kWh)}$ = Tariff in region z $_{(p/kWh)}$ - Tariff in cheapest region $_{(p/kWh)}$

[23] The regional DUoS unit rate differs between single rate and E7 meters (the latter has separate day and night unit rates). The regional adjuster would therefore be calculated separately for standard tariffs with a single unit rate and E7 standard tariffs.
[24] For the avoidance of doubt, the word 'tariff' refers to rates published in network charging statements in this sub-section only.

1.6. The regional adjuster would then be added to suppliers' advertised national unit rates to determine the total unit rate for each supplier in a given region. Importantly, all suppliers would be obliged to apply the regional adjuster to their unit rates.

Clarifying the approach

1.7. If Ofgem were to set a regional adjuster, four technical issues would need to be considered:

- how to convert some network charges from pence per peak day kWh (p/pdkWh) into p/kWh;
- how to define load factors and peak share;
- how to define the regions on which the regional adjuster will be based; and
- how to treat Independent Distribution Network Operators (IDNOs) and Independent Gas Transporters (IGTs).

1.8. Each of these issues is discussed below.

Converting some network charges into p/kWh

1.9. The regional adjuster formula presented above relies on tariffs being published in p/kWh. However, in some cases network charges are based on peak consumption / peak load and are priced as p/pdkWh. As such, we need to convert these charges into p/kWh before we can apply the regional adjuster if we are to calculate an 'equivalent tariff'. Table A2.2 details the formulae we propose to use to make these adjustments.

Table A2.2: Network charges and conversion formulas

Fuel	Element of network charge	Formula to convert p/pdkWh into p/kWh
Gas	LDZ capacity	Equivalent tariff $_{(p/kWh)}$ = Tariff $_{(p/pdkWh)}$ / Load factor $_{(\%)}$
	Customer capacity	
	NTS exit capacity	
Electricity	TNUoS	Equivalent tariff $_{(p/kWh)}$ = Tariff $_{(p/pdkWh)}$ * Peak share $_{(\%)}$

Defining load factors and peak share

1.10. The conversion formulae include two important variables – load factors and peak share. The sources of these data would be as follows:

- **Load factors** would be taken from annual tables available from the Energy Networks Association, the organisation that represents transmission and distribution network operators.[25] The category that would be used for domestic customers is 'small non-daily metered supply points'.

- Our estimates of **peak share** would be based on demand profile data provided by ELEXON, an electricity settlement company. We would obtain profile average demand data, by settlement period, for Profile Class (PC) 1 and PC 2 meters. The PC 1 data would be used to calculate the peak share for single rate meters, which would be used for setting the regional adjuster for standard tariffs with a single unit rate. The PC2 data would be used to calculate the peak share for E7 meters and would feed into the regional adjuster for E7 tariffs. The peak period would be defined as 4pm-7pm.

Definition of 'regions'

1.11. The GB energy market is separated into eight gas distribution network regions and 14 electricity distribution regions, with the electricity regions being ex-Public Electricity Supplier (PES) regions.

1.12. To set a regional adjuster, we would need to decide which definition of 'region' should be used. If we used gas regions for the gas regional adjuster and ex-PES regions for the electricity regional adjuster, the regional adjuster would be cost-reflective, but rather complex.

1.13. Given our December RMR proposals to simplify tariff information and encourage consumer engagement in the market, we consider that having separate regions for gas and electricity consumers would not be appropriate. This approach would be complex and may confuse consumers when they try to understand their bill and when they compare tariff prices.

1.14. We therefore consider that it would be appropriate to use the ex-PES regions for the purposes of the regional adjuster for both gas and electricity. As well as reducing complexity, this approach makes it easier to calculate a 'standard equivalent' rate (particularly for dual-fuel non-standard tariffs) and reflects current supplier practice.

1.15. Under this approach, it would be necessary to map the gas distribution regions onto the ex-PES regions. Where the relationship between gas and ex-PES regions is

[25] Load factor tables for 2011/12 are available at: http://www.gasgovernance.co.uk/sites/default/files/Load Factors for 2011_2012.pdf.

unclear we propose to use postcode mapping. We consider that this will be a relatively straightforward exercise.[26]

1.16. Once the postcode mapping has been completed, we would derive a gas charge for each ex-PES region by calculating a weighted average on the basis of the number of customers in each of the relevant gas regions. This approach would ensure the standing charge reflects the average gas network charge faced by customers within each ex-PES region, although it may not equal the costs faced by individual consumers.

1.17. A slightly different approach would be taken for NTS exit capacity charges:

- Gas NTS exit capacity charges will need to be allocated across the electricity regions. We have a list of NTS / GDN exit nodes. We would use information about the postcodes of the electricity distribution zones to allocate each node to an ex-PES region.
- GDNs book NTS exit capacity by NTS exit node but NTS exit capacity charges are currently set by exit zone. Therefore, we would obtain a list of which exit zones each exit node is in from National Grid Gas, in order to allocate an NTS exit charge to each node.
- We would then derive a weighted average NTS exit capacity charge by ex-PES region where the relative capacity volumes would be the weights.

IDNOs and IGTs

1.18. Some domestic consumers are served by IDNOs and/or IGTs rather than the main distribution network. While customers connected to IDNOs face the same DUoS charges as DNO end users, use of system charges for IGT end users differ from those connected to a GDN. We have therefore considered how the standardised element should account for IGTs.

1.19. End users on IGT sites connected since 2004 are under a relative price control (RPC). End users on IGT sites connected before 2004 are subject to 'legacy' arrangements, whereby they are charged as they were prior to the introduction of RPC and will eventually 'migrate' to RPC. The vast majority of end users on IGT sites are subject to a RPC and face charges that are typically a little lower than those levied on end users connected to GDNs. Therefore, we propose that customers on IGT sites would face the same standing charge as those connected to the GDN.

[26] We have received data from xoserve, a gas transmission services organisation, which contains the number of gas meter points at each six / seven character postcode in GB. We also hold Consumer Focus data on the three / four character postcodes that are included in each ex-PES region. We therefore consider that it will be a relatively straightforward exercise to map each xoserve data point to an ex-PES region.

1.20. Suppliers would not be permitted to apply an additional charge to IDNO or IGT customers.[27]

[27] Some suppliers currently apply an additional charge for dealing with the IDNOs / IGTs. More broadly, our current proposals and legal drafting would not prohibit suppliers from levying separate one-off charges for the provision/rental of meters and there are potentially other elements of service provision that suppliers could start to charge separately. The levy of additional charges to standard tariffs would be somewhat contrary to our objective of simplification. We will consider how best to tackle this issue within our RMR proposals in the coming months through the legal drafting of the licence conditions.

Appendix 3 – Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

Question 1: Do stakeholders agree with our proposed approach to those costs that should be recovered through a standing charge and those costs that should be recovered through a unit rate?

Question 2: Do stakeholders have any comments on the proposed broad assessment of the possible elements of the standing charge (set out in Appendix 1)?

Question 3: Do stakeholders have any comments on the treatment of regional cost differences? Do they favour Option 1 or Option 2?

Question 4: Do stakeholders have any comments on the assessment of the individual elements of the possible regional adjuster (set out in Appendix 2)?

Question 5: Do stakeholders agree with our proposed treatment of the standing charge (based on a broad assessment) and possible regional adjuster (using a formulaic approach) in the licence conditions?

Question 6: Do stakeholders agree with the proposed timing of any potential changes to the standing charge and possible regional adjuster?

1.3. Responses should be received by **02 April 2012** and should be sent to:

rmr@ofgem.gov.uk
Retail Markets
Ofgem
9 Millbank
London
SW1P 3GE

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to Chris Smith, Economist, Retail Markets (rmr@ofgem.gov.uk).

Appendix 4 – Glossary

C

Carbon Emissions Reduction Target (CERT)

A government policy that requires all domestic energy suppliers with a customer base in excess of 50,000 customers to make savings in the amount of CO_2 emitted by householders. Suppliers meet this target by promoting the uptake of low carbon energy solutions to household energy consumers, thereby assisting them to reduce the carbon footprint of their homes.

Community Energy Saving Programme (CESP)

A government policy that targets households across Great Britain, in areas of low income, to improve energy efficiency standards and reduce fuel bills. Suppliers provide funding for the programme.

D

Department for Energy and Climate Change (DECC)

The UK government department responsible for policy and regulations in the fields of energy and climate change.

Distribution Use of System (DUoS) charges

The charges paid by electricity suppliers to distribution companies for use of the electricity distribution system.

Distributor Network Operators (DNO)

DNOs came into existence on 1 October 2001 when the ex-Public Electricity Suppliers were separated into supply and distribution businesses. There are 14 DNOs covering discrete geographical regions of Britain. They take electricity off the high voltage transmission system and distribute this over low voltage networks to industrial complexes, offices and homes. DNOs must hold a licence and comply with all distribution licence conditions for networks which they own and operate within their own distribution services area.

Distribution system

A local network that connects electricity/gas from the transmission system to end consumers at lower voltage/lower pressure.

Domestic customer

A customer that uses energy wholly or mainly for domestic purposes.

Domestic energy suppliers

Companies who sell energy to and bill domestic customers in Great Britain.

Dual Fuel

A type of energy contract where a customer takes gas and electricity from the same supplier.

E

Economy 7 / Economy 10

A type of tariff that has different unit rates for consumption during the day and during the night. The number following 'Economy' refers to the number of hours for which night-time rates are available.

Energy Company Obligation (ECO)

A forthcoming government policy that will replace CERT and CESP. Suppliers would provide funding for this policy.

Ex-PES

The previous Public Electricity Supplier (PES) for one of the 14 electricity regions in England, Wales and Scotland. From privatisation in 1990 until 1998 the ex-PES had a monopoly of electricity supply and distribution in their designated areas. Local distribution is still a monopoly regulated by Ofgem, however, competition has been introduced in supply, and so these 14 suppliers (consolidated now into five) are known as ex-PES suppliers. The 14 regions are detailed below, together with the name of today's ex-PES company for each region.

Region	Supplier Group
London	EDF Energy
Seeboard	
SWEB	
East Midlands	E.ON UK
Eastern	
Norweb	
Midlands	RWE npower
Northern	
Yorkshire	
Scottish Hydro	SSE
Southern	
Swalec	
Manweb	Scottish Power
Scottish Power	

G

Green Deal

A forthcoming government policy that will allow householders to install energy efficiency measures with no up-front cost. The costs will be re-paid through energy bills.

K

kWh

Kilowatt-hour is a unit used to measure energy consumption in both electricity and gas.

M

Market Share

The proportion of total customers (usually as proxied by the number of meter points) within a market that are registered to a particular supply group.

S

Small suppliers

Suppliers which operate in the domestic gas and electricity market but do not hold significant market share. This can refer to all suppliers other than the Big 6.

Standard contract

A supply contract of indefinite duration which may be terminated by the customer by giving notice in accordance with the contractual terms, e.g. 28 days' notice.

Supply Licence Conditions (SLCs)

The legally binding conditions that gas and electricity suppliers must meet to supply to domestic and non-domestic customers, in accordance with the Gas Act (1986) and Electricity Act (1989).

Switching

The process of changing gas or electricity supplier, or changing to a new tariff with the same supplier.

T

Termination (exit) fees

The contractually agreed price a customer must pay (where part of their contract) if they terminate their contract before the agreed contract end date.

Transmission Network Use of System (TNUoS) charges

The charges paid by electricity suppliers to the System Operator for use of the transmission system. The System Operator is National Grid Electricity Transmission plc.

Transmission system

The system that transfers electricity/gas at high voltage/pressure around the UK before distribution to end consumers. For electricity this will be the overhead lines, underground cable and substations. For gas this is the high pressure pipes and compressor stations.

W

Warm Home Discount

The Warm Home Discount scheme mandates domestic energy suppliers to provide approximately £1.13 billion of direct and indirect support arrangements to fuel poor customers over four years from April 2011.

Appendix 5 – Feedback Questionnaire

Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

Please send your comments to:

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