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Sent by email to: StandingCharges@ofgem.gov.uk

Dear James

Standing charges – call for input¹

Centrica welcomes the opportunity to respond to the call for input (CFI). As Ofgem correctly notes, numerous stakeholders, including consumers, consumer representatives, media stakeholders and suppliers have raised concerns regarding the impact of the growth of standing charges in recent months, so a review is both timely and appropriate.

From Centrica's perspective, however, the issue is not simply about the growth of standing charges amid wider pressures on affordability. It is also about the need for simplification to support consumer understanding and engagement in the broader context of a just and fair energy transition.

Achieving net zero goals will require widespread application of time of use (ToU) tariffs to support demand side response and cost-effective system transition, including on capped tariffs. But it is not appropriate simply to layer additional complexity for consumers on top of an approach to charging which many already find hard to understand and navigate; such an approach will not be conducive to restoring consumer trust.

We believe continued price protection is appropriate and necessary to support energy transition and that the price cap will need to evolve accordingly. The first step is to remove unnecessary complexity by phasing out standing charges on capped tariffs and unwinding the postcode lottery of regional pricing differentials as a precursor considering broader cap reform to ensure compatibility with half-hourly settlement and ToU.

¹ [Standing charges – call for input | Ofgem](#)

Wider affordability should be addressed via an exchequer funded Social Tariff for those most in need. This will enable an overall progressive outcome while mitigating risks to vulnerable customers Ofgem is concerned may lose out from change. In this respect, we agree with Ofgem's CEO when he stated: *"we think that there is a case for examining, with urgency, a social tariff that limits the impact of extremely high prices and reduces volatility for a defined set of vulnerable groups. To be clear, this tariff would need to be subsidised when prices are high and preferably paid for through funds raised in a progressive way"* while also noting that *"ultimately, as with the strategy to tackle the wider affordability of energy, this is a matter for government."*²

As detailed further in response to the specific consultation questions, Ofgem needs to act on two fronts to facilitate lower (or zero) standing charges under the cap:

- **Review the current approach to network charge cost recovery:** We note that there are already a number of code modifications seeking exemptions or relief from residual charges. We also note the government decision to offer network charging relief to Energy Intensive Industries (EII). Whether it be the impact of the move to a fixed charge recovery of residual on 'peaky' customers, EII customers, or EV charging point providers, any relief provided to one user group will act to place a greater residual burden on remaining customers and lead to ever more groups of users seeking relief. This dynamic is evident before we consider the impact of the increase in overall network costs that is likely to feed through to higher residual costs. In our view, this combination of calls for relief increasing the burden on remaining customer and forecast increases in the overall quantum of residual network costs warrants consideration of moving residual recovery to a blanket p/kWh approach and believe Ofgem should include this within the scope of its post-implementation review of the Targeted Charging Review.
- **Review price cap design to allow fixed cost recovery via unit rate:** While the approach to recovery of network costs is responsible for the lion's share of recent increases in nil consumption cost facing suppliers, other cost categories are also material. Under the current price cap methodology operating costs, policy costs and other costs also contribute to the nil consumption benchmark. As Ofgem notes, if these costs are not met through standing charges they would need to be added to unit rates or some other charging methodology. There is a public policy case for recovering some policy costs through progressive taxation rather than from bill payers via standing charges which tends to be regressive, although we appreciate this is primarily a policy matter for government rather than Ofgem. Ofgem is, however, responsible for the design of the price cap and decisions on how to apportion cost recovery between nil consumption and benchmark consumption.

We look forward to engaging further with Ofgem on these matters as its review of standing charges unfolds.

Yours sincerely

Don Wilson
Retail Market Design and Policy

² [Jonathan Brearley's speech at the Institute for Government | Ofgem](#)

Appendix 1: Response to Ofgem consultation questions

Chapter 3 - Standing charges, network charges and the price cap

Q1: *What are the barriers to suppliers using the existing flexibility under the price cap?*

Ofgem states at 3.17:

“The price cap is not a cap on the level of the standing charge or unit rate, but on the overall cost of supply at a certain volume. As long as the customer is not charged at a level above the relevant price cap for the volume of energy that the customer uses, how a supplier chooses to set the standing charge and unit rate is a commercial decision for them.”

We respectfully disagree with this statement and the implication that suppliers are not, in practice, severely constrained by the price cap for the following reasons:

- The suggestion that there is no cap on the standing charge but only *“on the overall cost of supply at a certain volume”* is a distinction without a difference. The price cap explicitly specifies the maximum charge at nil volume, thereby imposing an effective cap on the level of the standing charge.
- Critically, while the cap ostensibly sets maximum rather than minimum charges it does not follow that suppliers enjoy unrestrained commercial freedom to rebalance cost recovery between standing charges and unit rates.
- Ofgem explicitly stated in its 2018 Decision that *“We recognise that our intended design might reduce suppliers’ ability to provide tariffs with low or no standing charges.”* This remains the case notwithstanding the “derogation” Ofgem refers to.
- In theory, the “Direction for Alternative Compliance Assessment” rubric in the licence condition may enable suppliers to charge low consuming customers higher unit rates than the benchmark maximum charge assumes in specific circumstances. In practice, however, it does not provide a “derogation” to charge more than the cap allows at any consumption level because any charge in excess of the cap must be refunded to the customer through a rebate.
- Consequently, the extent of the flexibility afforded by the derogation amounts to no more than *theoretical* flexibility to charge less than the cap allows up to the point where the cap would otherwise be breached.
- As Ofgem itself notes *“no active suppliers have sought to use this flexibility to offer low or no standing charge tariffs.”* This is wholly unsurprising; any supplier who sought to offer no or low standing charge (capped) tariffs would be unable to recover the level of efficiently incurred costs assumed by the cap. They would be bound to under-recover from any consumer consuming less than the assumed break-even consumption level. In addition, they would be unable to make good any shortfall in respect of low consuming customers by higher unit charges on consumption above that level due to rebates.

- In other words, as the cap is currently designed disapplying standing charges while still complying with the cap effectively prevents recovery of efficiently incurred costs in aggregate, which is plainly not commercially sustainable on a widespread basis.

Q2: Why are suppliers not innovating on standing charges for tariffs not covered by the price cap?

Suppliers are not only constrained by regulation in relation to price capped tariffs. The sharp rises in regulated network costs charged on a fixed basis are common across all tariff types. The higher the level of fixed per customer/per premises costs the bigger the risk of under-recovery through volume related charges. These risks are compounded by adverse selection risk i.e. the risk that higher unit rates and low or no standing charges will only be attractive to low consuming consumers providing limited opportunity to recoup fixed cost recovery shortfalls from higher unit charges even though these are not explicitly regulated. Ofgem rules require suppliers to provide customers with the information needed to make informed choices about how they manage their costs and consumption.³

Other regulatory constraints are also relevant. The price cap provides a free option to all customers. If the unit rates implied by the price cap are below those of a competitive tariff with no standing charges it may be perfectly rational for engaged consumers to prefer the cap (unless they are low consuming consumers themselves). The price cap thus acts as an ‘anchor’ on the structure as well as the level of competitively offered tariffs.

We do not propose that standing charges should be prohibited for tariffs not subject to the price cap. Such a move could unnecessarily impede tariff innovation e.g. to support “energy as a service” propositions. However, as discussed further below, Ofgem also needs to reconsider its approach to network charges as part of the post TCR implementation review.

Q3: What changes could Ofgem make to improve provision for lower standing charges under the cap?

Ofgem needs to act on two fronts to facilitate lower (or zero) standing charges under the cap:

- **Review the current approach to network charge cost recovery:** We note that there are already a number of code modifications seeking exemptions or relief from residual charges. We also note the government decision to offer network charging relief to Energy Intensive Industries (EII). Whether it be the impact of the move to a fixed charge recovery of residual on ‘peaky’ customers, EII customers, or EV charging point providers, any relief provided to one user group will act to place a greater residual burden on remaining customers and lead to ever more groups of users seeking relief. This dynamic is evident before we consider the impact of the increase in overall network costs that is likely to feed through to higher residual costs. In our view, this combination of calls for relief increasing the burden on remaining customer and forecast increases in the overall quantum of residual network costs warrants consideration of moving residual recovery to a blanket p/kWh approach and believe Ofgem should include this within the scope of its post-implementation review of the Targeted Charging Review.

³ [Guide to the customer comms rule changes \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/guide-to-the-customer-comms-rule-changes)

- **Review price cap design to allow fixed cost recovery via unit rate:** While the approach to recovery of network costs is responsible for the lion's share of recent increases in nil consumption cost facing suppliers, other cost categories are also material. Under the current price cap methodology operating costs, policy costs and other costs also contribute to the nil consumption benchmark. As Ofgem notes, if these costs are not met through standing charges they would need to be added to unit rates or some other charging methodology. There is a public policy case for recovering some policy costs through progressive taxation rather than from bill payers via standing charges which tends to be regressive, although we appreciate this is primarily a policy matter for government rather than Ofgem. Ofgem is, however, responsible for the design of the price cap and decisions on how to apportion cost recovery between nil consumption and benchmark consumption.

While lowering standing charges on capped tariffs may benefit some customers it will not deliver the wider simplicity benefit that no standing charges and no regional differentials on capped tariffs would provide in terms of supporting customer understanding and engagement. As discussed further below, we see simplification as a necessary precursor to evolution of default tariff pricing which provides price protection while also supporting energy transition and decarbonisation goals.

Q4: As a result of TCR and changes to the recovery of residual costs, domestic consumers with very low consumption now bear a share of fixed network costs which is more in line with the cost of maintaining access to gas and electricity networks. Is this fair? Should more be done to shield these customers from these costs?

As noted in response to Q3 we believe there is a case for reviewing the current approach to recovery of residual costs as part of the post-implementation TCR review. It would have been possible to address the specific problems associated with charging residual costs only on peak consumption by moving to recover across all consumption rather than on a strict per customer/per site basis, and we think this approach now merits reconsideration.

Fairness to domestic consumers with very low consumption is an important consideration, although we believe the case for moving away from standing charges on capped tariffs altogether needs to be seen in the broader context of just and fair energy transition. Achieving net zero goals will require widespread application of time of use (ToU) tariffs to support demand side response and cost-effective system transition including on capped tariffs. But it is not appropriate simply to layer additional complexity for consumers on top of an approach to charging which many already find hard to understand and navigate; such an approach will not be conducive to restoring consumer trust. We believe continued price protection is appropriate and necessary to support energy transition and that the price cap will need to evolve accordingly. The first step is to remove unnecessary complexity by phasing out standing charges on capped tariffs and unwinding the postcode lottery of regional pricing differentials as a precursor considering broader cap reform to ensure compatibility with half-hourly settlement and ToU.

Wider affordability should be addressed via an exchequer funded Social Tariff for those most in need. This will enable an overall progressive outcome while mitigating risks to vulnerable customers Ofgem is concerned may lose out from change. In this respect, we agree with Ofgem's CEO when he stated: *"we think that there is a case for examining, with urgency, a social tariff that limits the impact of extremely high prices and reduces volatility for a defined set of vulnerable groups. To be clear, this tariff would need to be subsidised when prices are high and preferably paid for through funds raised in a progressive way"* while also noting

that “ultimately, as with the strategy to tackle the wider affordability of energy, this is a matter for government.”⁴

Q5: What are the reasons for regional variations in electricity standing charges?

The short answer as to why there are regional variations is underlying difference in network charges by region, further entrenched through price cap design.

Q6: Can we learn from other sectors about how to improve suppliers’ tariff offering in the UK energy market?

We think the general lessons to be learned from other sectors are quite limited but note the following from Ofgem’s discussion of water and telecoms sector experience:

- Regulated wholesale cost inputs are an important factor where applicable (i.e. more so in competitive retail telecoms markets than vertically integrated water monopolies);
- Direct regulatory constraints at retail level are a minor factor in telecoms compared to energy with its broadly based retail price cap;
- Retail offers have evolved over time in other sectors in response to customer needs and preferences in ways which are not strictly cost-reflective.

On a point of detail, while Ofgem notes that the mobile sector has never had standing charges early iterations of mobile prepay featured time limited top-up expiry irrespective of usage which could be seen as akin to a standing charge. Customer dissatisfaction with this charging model provided a commercial opportunity for positive differentiation through top-ups with no expiry,⁵ an initiative subsequently followed by all networks as customer demand for this innovation became apparent.

Chapter 5 - Standing charges and the domestic retail market

Q7: Why do so few suppliers offer multi-tier or zero standing charge tariffs to their customers?

As discussed above, a combination of network charges and cap constraints drive risk that suppliers would be unable to recover efficiently incurred costs on such tariffs.

Q8: Why are zero standing charge tariffs no longer offered in the market, with the exceptions cited in this paper?

The answer to Q7 above applies equally here.

⁴ [Jonathan Brearley's speech at the Institute for Government | Ofgem](#)

⁵ [THERE'S NO OUCH IN OUR VOUCHER, A United Kingdom Trademark of Orange Brand Services Limited. Application Number: UK00002214255 :: Trademark Elite Trademarks](#)

Q9: What measures could Ofgem take to improve the range of tariffs available to domestic retail customers?

We interpret “improve the range of tariffs available to domestic retail customers” as the phase out of standing charges on default tariffs subject to the price cap. As explained more fully in response to Q3 above, the key measures Ofgem should take to support this are to review network charges and the price cap methodology.

Q10: Why do no suppliers offer rising block tariff products at present? Would these products offer benefits to consumers?

Rising block tariffs entail an even greater risk for suppliers of being unable to recover fixed costs than that already applicable to tariffs with no standing charges. Moreover, it is far from clear that such tariffs would benefit customers generally. We note that Ofgem previously outlawed such tariffs on the grounds that they would be too complicated for customers to understand and compare, stating:

“From today, Ofgem is banning suppliers from offering complex tariffs, for example where consumers are initially charged a higher rate, which falls the more they use. The reforms also mean that once a consumer has decided how they want to pay for energy they will have just four tariffs to choose from for gas and four for electricity, from each supplier. Together these changes will make it far easier for consumers to compare deals and find the best tariff for them.”

Another major issue for customers is comparability, if every supplier offered rising block tariffs with different structures and prices it would be very challenging for a customer to actually know & understand which deal is going to be cheaper for them and why.”⁶

Achieving net zero goals will require widespread application of ToU tariffs to support demand side response and cost-effective system transition, including on capped tariffs. Rising block tariffs based purely on volume are not compatible with tariff design aiming to incentivise demand response to specific ToU price signals.

Q11: How significant an impact do standing charges have on customers’ incentives to use energy efficiently? What evidence can you provide that this is the case?

To the extent that lower standing charges result in higher unit charges they will tend to sharpen incentives to use energy efficiently. There is strong evidence that the higher energy costs experienced since the recent crisis have led to consumers to adjust their consumption in response.

Gas and electricity demand in 2023 was significantly lower than 2022 continuing the pattern noted in July’s Digest of UK Energy Statistics: *“Demand for households and industrial use fell on the back of record temperatures in 2022 and higher energy and other prices. The fall in household demand was most notable in the final quarter of 2022, which showed a drop of*

⁶ [Finding a better deal on your energy is getting easier from today | Ofgem](#)

14 per cent for gas and 11 per cent for electricity despite similar temperatures to the previous year."⁷ (Emphasis added)

Q12: Are there any forms of intervention in standing charges that Ofgem might consider that would minimise the risk of producing negative outcomes for some customers?

As discussed above, we consider Ofgem should phase out standing charges on default tariffs subject to the price cap, and phase out regional differentials for all residential customers. This will involve review of network charges as well as detailed cap design. In addition, Ofgem should continue to urge Government to address affordability concerns for particular groups of customers through a well-designed and targeted social tariff funded through progressive taxation rather than cross-subsidy from other bill payers.

Q13: How can we identify the complex needs of vulnerable customers and ensure that they are able to receive tariffs that benefit them the most?

This is a complex question, but the high-level answer is that Ofgem will need to work closely with Government on the detailed design of social tariff targeting to address particular affordability needs.

There may be trade-offs between the extent of support provided, scope and the degree of tailoring to individual circumstances that Government will need to weigh up. However, funding below cost tariffs to support affordability concerns should be met from progressive taxation rather than cross-subsidy from other bill payers, and Exchequer funding is necessarily a matter for Government to determine.

From a practical perspective too, it is important to recognise that the information available to energy suppliers is limited and it is not appropriate to delegate decisions on eligibility to Ofgem or suppliers. Sophisticated targeting involving factors such as benefit entitlement, medical conditions and building energy efficiency ratings requires data matching co-ordinated across government as has long been proposed (though not yet fully delivered) for administration of the Warm Home Discount scheme.

Chapter 6 - Standing charges in the non-domestic retail market

Q14: What issues affecting standing charges in the non-domestic retail sector should we consider further?

Unlike the domestic retail market the non-domestic sector is not subject to price cap regulation, and we see no case for limiting commercial pricing freedom on competitive tariffs.

We agree with the desired outcomes of the TCR approach in improving cost reflectivity recovery by businesses, however the mechanics of how this works has disproportionately impacted some businesses with relatively low consumption. Further, as the TCR banding was applied for non-half hourly (NHH) meters and Whole Current half hourly (HH) meters based on consumption at a single point in time, but then is managed through line loss factor

(LLF) codes it will not reflect any changes in consumption for a business and will mean that businesses (whose consumption is inherently less stable than domestic customers due to growth or shrinkage of their business) are likely to over time become less cost reflective of the actual costs of the network.

This has also created a perverse situation where the TCR bandings are spaced relatively closely together, creating a cliff edge approach to costs (from 0-25 MWh), whereas costs do not change regardless of a business size from 25MWh+. This can see customers see increased TCR costs up to 10x larger whilst still being classified as a Small, Micro Business with little rationale as to why this is appropriate and reflective of their true costs.

A fairer approach would be to manage the costs of TCR by consumption (rather than LLF) to reflect a customer's evolving consumption alongside either moving some cost to the unit rate to ensure larger consuming businesses pay a larger amount of network costs, or to increase the number of consumption bandings. Both approaches would be designed to reduce the cliff edge of increasing costs on the smallest business consumers and to not act as a deterrent to business growth, whilst improving fairness of cost recovery based on a business's size.