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Ofgem - Standing Charges: Call for Input

Contact:

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Summary

Energy Systems Catapult welcomes the opportunity to respond to Ofgem's call for input into standing charges in retail energy products.

The Catapult was set up to accelerate energy innovation towards Net Zero, and in doing so enable that UK businesses and consumers to capture the opportunities of clean growth. The Catapult is an independent, not-for-profit centre of excellence that bridges the gap between industry, Government, academia, and research. We take a whole systems view of the energy sector, including in policy design and implementation, helping us to identify and address innovation priorities and market barriers, to decarbonise the energy system at the lowest cost.

We make three broad observations with regard to Ofgem's call for input and the questions therein:

Strategic alignment with retail reform

We welcome Ofgem opening up the debate on different forms of retail energy tariffs – a subject the Catapult highlighted in our [Clean Energy Retail](#) report in 2022. However, it is difficult to tell how the timing and scope of the call for input relates to the Department for Energy Security and Net Zero's programme on retail energy reform.

This is not a trivial matter of the volume or sequence of consultations that stakeholders need to engage with – the matters raised in Ofgem's call for input relate to the fundamental design and regulation of and expectations from the retail energy market. Without clearer alignment, there is a risk that Ofgem and DESNZ's interventions on energy retail would contradict each other. A lack of alignment also risks sending mixed messages to stakeholders who are having to concurrently navigate the technology, financial and regulatory aspects of the transition to zero carbon energy.

We recommend that Ofgem seeks to feed into DESNZ's programme, and that concerns around standing charges are addressed in a wholistic way through that programme. The Catapult submitted a [comprehensive response](#) to DESNZ's call for evidence on retail innovation, and would be happy to discuss our views with Ofgem.

The role of regulation in inhibiting retail innovation

A constant theme through Ofgem's call for input is a concern about the lack of innovation and differentiation in the pricing structures of retail energy products. We share Ofgem's concern. But we think that the call for input did not pay sufficient attention to a number of matters that play an outsized role in the lack of retail innovation.

- Ofgem acknowledges that standing charges reflect legitimate system costs, which must be recovered from consumers in one way or another. Not stated within Ofgem's paper – but

perhaps implied – is that retailers will need to ensure that revenues earned from their customers fully cover the costs that the retailer is liable for. The easiest way for a retailer to do that is through tariff structures that seek to mirror the underlying cost structures as closely as possible (cost pass-through).

- Since privatisation of retail energy Ofgem and policy-makers has been overly focused on switching rates as the main measure of whether the market is effectively competitive. The message this sends to retailers is to minimise investment in consumer satisfaction and retention, hence little in the way of innovation and differentiation.
- The retail price cap has essentially formalised the cost pass-through approach to energy products. Retailers no longer face the risk of losing customers if they are the first to raise prices, meaning there is even less of an imperative for them to offer products that insulate customers from price rises.

Ofgem notes that the telecoms sector is characterised by products that are much more effective at meeting consumers' different needs. Technological advancements played an important role in the transformation of the telecoms sector, to consumers' benefit. Similar advancements are now available in the energy sector - such as distributed energy resources and smart home controls – and mean that a similar consumer-friendly transformation is increasingly possible in the energy sector. But the rollout of technology must be accompanied by a change of mindset about what makes for an effective retail market and, with it, a change to the regulations that aim to protect consumers from price rises.

Ways for Ofgem to learn quickly what works

Ofgem's call for input includes modelling that aims to illustrate the impact of reallocating costs between standing charges and unit charges. But the call for input also acknowledges that there are important unknowns about the extent to which current tariff structures discourage households from investing in energy efficiency, or how consumers might respond to different tariff structures.

We think that the best way to find out what works – and what does not – is by testing with actual customers, in low-risk real-world situations. Our [Living Lab](#) of over 2,000 digitally connected homes across the UK offers one such testbed. Ofgem's concurrent consultation on developing a 'Future Regulation Sandbox' to conduct such regulatory experiments is a welcome step, and we encourage use of the Sandbox to test ideas for retail energy reform.

We would be happy to further discuss any of the above with you.

Sincerely,
Ben Shafran