

Case for Change

Q1. Do you have any views on our case for change?

- Allocating costs to unit rate over standing charge is in the best interests of customers
- Electricity network costs are best placed to be reallocated to unit rates
- The model must allow all Parties to recover their efficiently incurred costs
- Ofgem must not expect any further reduction in Supplier operational costs.

Ofgem's primary concern here should be acting in a manner which represents customers' best interests. Enabling customers to control their energy costs is evidently in their interests, as they stated through the preceding Call for Input. Any reduction in standing charges supports this goal.

Allocating charges to unit rates enables customers to reduce their energy costs by reducing consumption. Placing greater relative weight on volumetric charges puts control and accountability back in the hands of customers, whilst simultaneously facilitating the net-zero transition by incentivising consumption reduction.

Utilita already offer tariffs (both credit and prepayment) without standing charges. Standing charges disproportionately impact customers who consume less. Those who consume less will have lower bills, and thus a flat standing charge allocation is a proportionally a larger increase for these customers. This also means that standing charge allocations detract from such customers' incentives to monitor and reduce their own consumption, as this has a relatively lower impact on their ability to reduce costs. It is important to recognise that reduced consumption is often driven by affordability challenges. It is for this reason that our general principle is to support the allocation of costs to the unit rate over the standing charge.

This approach is not without consequence, as the risk of under-recovery of costs is increased. This is especially true for Suppliers with customers which consume less than average. This does not mean it is not the right decision. Ofgem must simply ensure that any risks are fully accounted for in the design of the price cap.

Any charges reallocated to the unit rate would be required to be uplifted by a risk premium which accounts for the risk of under recovery. There is no way to make costs disappear simply through reallocation.

Ofgem must consider how to minimise this risk premium. Networks are best placed to offer lower premiums due to their lower business and financial risk. Their guaranteed returns model and lower cost of capital would require a lower premium to be applied to unit rates than that of a Supplier. Moving electricity network charges back to unit rates would have the most significant impact if Ofgem's objective is to meet the interests of customers at the lowest possible cost. This is clearly possible as Gas distribution costs are volumetric.

Considerations for shifting operating costs from standing charges to unit rates

Q2. What are your views on the range (£20-£100) of operating costs we are considering shifting from standing charges to unit rates? Should it be higher? Within this range, is there a value you would favour and why?

If the approach taken is to produce a model which best represents customers stated interests, then shifting a higher value best supports this approach.

Ofgem's impact assessment does not specify which specific operating cost categories could be reallocated to reach this £20-100 target. The current operational cost categories have been subject to significant review and consultation since the introduction of the cap. They remain under scrutiny through the ongoing Operational Cost Review consultation. It appears that there are no clear candidates within the Operational Cost elements of standing charge that are better linked to volumetric charging.

This new focus on Supplier Operational costs is contradictory to the approach taken to network costs under the TCR. As we have already stated, shifting costs to unit rate introduces the risk of under recovery. In terms of overall efficiency, it is more efficient to reverse the conclusions from the TCR and instead revert to electricity network costs returning to the unit rate.

This approach would have the most significant reduction in standing charges at the least risk. The relative risk premium which networks would have to build into their model would be lower than that of Suppliers – as networks have guaranteed returns, true-up mechanisms and have a much lower cost of capital.

Networks can still be offered the guarantees they rightly require to invest in their networks. There will be a need to sure up and balance year-end-outcomes.

Q3. What are your views on the trade-offs and impacts we have identified for consumers and suppliers? Should any of these take more or less significance in our assessment, and are there any important impacts we have not considered?

We believe that placing greater control in the hands of consumers to manage their energy costs is a positive. Ofgem correctly identify this as a trade-off (cross-subsidisation) between high and low users.

Our primary concern in protecting customers is that those most vulnerable and those who face insurmountable affordability challenges are not left in unacceptable situations. The only way to ensure this is the case, whilst still designing efficient markets, is to introduce out-of-model support for such customers (i.e. through targeted support schemes supported by general taxation or a social discount offering)

Q4. What are the changes required, if any, to the price cap to facilitate a reduction in the level of the operating costs charged through the standing charge?

Ofgem must recognise the risk of under-recovery and adjust the model accordingly. This was considered in the Targeted Charging Review. To de-risk network business while increasing risk to supply businesses is not seem cost effective or in the customers best interests.

Suppliers are already as incentivised as any other company to become more efficient. Such improvements allow them to compete on price and increase relative profit levels. The use of an operating cost allowance is only justified if clear, demonstrable inefficiencies exist which Suppliers would otherwise be unmotivated to resolve. In the absence of demonstrable operational inefficiencies, the cap has the potential to lead to suppliers cutting otherwise justifiable costs. Such cuts will lead to worse long-term outcomes for customers.

Here we wish to highlight that Utilita's standard tariff offering does not include a standing charge. We recover the costs which Suppliers usually attribute to the standing charge through differential block tariff pricing. This tariff is of huge benefit to our customers, and they are highly supportive of an offering which results in no charge if there is no consumption - many customers join us for this reason.

Whilst we support Ofgem's goal in reducing costs to customers, the cap is also intended to allow reasonable profits for efficient suppliers. Ofgem's own reporting shows that Suppliers have been making losses since 2019.

Increasing consumer choice through tariff diversification

Q5. Could mandating suppliers to have at least one low or no standing charge tariff available to customers help promote competition in this area of the market?

It is our view that any mandatory approach removes innovation and therefore competition. Utilita offer a no standing charge tariff, as do some other suppliers. Mandating one will ultimately remove choice from the market, especially given the tight margin control environment suppliers operate in.

Ofgem must allow Suppliers to compete. For a tariff structure to be viable, at a minimum it must reliably recover the cost incurred by the supplier at a tolerably low risk variance or shortfall at a rate that is competitive to attract customers. Suppliers must be allowed to make this judgement for themselves.

Q6. How could we create flexibility in how costs are recovered between the unit rate and standing charge without reducing the protection provided by the cap?

There is no getting away from the fixed cost nature of the costs currently included in the standing charge. Therefore, the key consideration is who is best placed to take on the introduced by volumetric charging.

The lowest risk element of the supply chain is the network and distribution companies with a regulated profit and true up mechanism in place already. They are best placed to take this risk. If Ofgem instead decide to reallocate Supplier operational costs then there is a clear inconsistency in Ofgem's treatment of market participants.

Q7. In enabling greater diversity in standing charges on default tariffs, what, if any, safeguards would be needed to protect vulnerable consumers?

There is a group of vulnerable high-consuming customers which require additional support – regardless of any changes made through this consultation. Certain vulnerabilities correlate highly with increased consumption, such as those with disabilities or dependency on medical equipment. These customers often face affordability issues and any allocation of cost to the unit rate is likely to be disproportionately detrimental to this group.

We do not believe it is appropriate to account for this through the structure of the cap. We believe the solution to this issue is the establishment of separate financial support initiatives. Such initiatives include the introduction of a social discount or increases to allowances through current benefit schemes.

Attempting to account for this group through fundamental market design risks delivering a model which is relatively inefficient. This group are incapable of flexing their demand and thus designing a model which aims to empower customers to do this appears impossible. Targeted support must be provided to these customers through means other than tariff structures.

Q8. What are the key considerations we should take into account in developing options for smoothing spend for prepayment meter customers?

Not all PPM customers need or want costs smoothed. Utilita already offers its customers a savings wallet to empower PPM customers to smooth the seasonality of costs.

A targeted discount to vulnerable consumers is the best mechanic to protect vulnerable customers.

Network and policy cost allocation

Q9. Do you have any views on our considerations for the allocation of network and policy costs

We address this in our answer to question 1.

Networks are best placed to offer lower premiums due to their lower business and financial risk. Their guaranteed returns model and lower cost of capital would require a lower premium to be applied to unit rates than that of a Supplier. Moving electricity network charges back to unit rates would have the most significant impact if our objective is to meet the interests of customers at the lowest possible cost.

This approach would minimise any further instability to the retail sector and associated cost of failure and uncertainty placed on affected customers.

Creating a framework where suppliers could opt to include network costs as either a unit rate or standing charge would open the door to real flexibility in retail tariffs as suppliers would be able to concurrently offer zero-standing charge alongside normal standing charge tariffs, without the financial risks and losses.

Ofgem mention the potential to shift some policy costs from standing charge to recovery via taxation- we believe this is a good idea. Much of what is recovered through energy bills better suited to recovery via general taxation.