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12 August 2025

Dear [redacted]

MANDATING LOW OR ZERO STANDING CHARGE TARIFFS: A TECHNICAL WORKING PAPER

We welcome the opportunity to respond to Ofgem's technical working paper on mandating low or zero standing charge (LZSC) tariffs, and our answers to Ofgem's consultation questions are in Annex 1. We support Ofgem's overarching objectives to enhance consumer choice and control, particularly for vulnerable and low-usage customers. However, we believe that any regulatory intervention must be carefully balanced to avoid unintended market distortions and maintain a fair and competitive retail energy market. It is also vital that this measure is coherent with Ofgem's initiatives to increase demand-side flexibility.

Keeping suppliers financially whole

We welcome Ofgem's confirmation (para 2.3) that this intervention is not designed to address affordability issues and that suppliers should be able to recover efficient costs. As Ofgem has recognised, this means that if some customers save money on a LZSC, other customers must pay extra if the supplier is to be kept financially whole. It is essential that Ofgem maintains this principle, in line with its statutory duty to enable licensees to finance their licensed activities.

Fixed term tariff versus price cap variant

Ofgem is now proposing to require suppliers to offer LZSC tariff options without requiring that they should be available as standard variable tariffs (and hence subject to the price cap). We think this is a sensible change to Ofgem's previous proposals as it will increase suppliers' flexibility and reduce the complexity of aligning new tariff design requirements with the price cap, and potentially give suppliers greater opportunity to mitigate their risks. However, we think suppliers should be able to meet their new obligations by offering variable LZSC tariffs rather than FTCs should they choose to do so. This would require a dispensation within the price cap for suppliers to charge a

higher unit rate for LZSC tariffs subject to demonstrating a reasonable expectation that customers on the tariff would not be worse off in aggregate.

Squaring the circle of commercial viability and customer attractiveness

The key challenge for suppliers in offering LZSC tariffs will be how to balance the competing objectives of commercial viability (ie suppliers don't lose money) with customer attractiveness (ie a reasonable number of customers switch to it, on a fully informed basis). We proposed a consumer behavioural model in our consultation response of 20 March to help understand these trade-offs and we have included our model description in Annex 2 of this response. As illustrated in our model results, there are a number of steps that can be taken to mitigate the commercial impact and make it more likely that this balance can be struck, notably:

- Requiring a 'low' standing charge rather than a zero standing charge
- Adopting falling block rather than single rate tariff designs
- Excluding customers with consumption below a specified threshold
- Limiting availability to customers with PPMs
- Limiting availability to customers with smart meters

We believe suppliers should be given discretion to select from this list of mitigating measures as they see fit, subject to an overall requirement of maximising attractiveness to their target set of customers (see below). Some suppliers may choose to offer more attractive LZSC tariffs albeit to a narrower set of eligible customers. Other suppliers may choose to make their tariffs more universally available, but with the consequence that their tariff parameters are attractive to a smaller proportion of customers. Rather than 'picking winners', Ofgem should encourage diversity and allow competition between suppliers to discover what works best.

How to assess compliance

Given the current uncertainty over consumer behavioural preferences (how much extra are they prepared to risk paying on their bill for the notional benefit of 'control'?), it will be extremely difficult for Ofgem to prescribe in advance any objective test of 'fair value' or reasonableness of LZSC tariff offerings. Ofgem's compliance test should be 'is this tariff unnecessarily unattractive to consumers such that the supplier can be deemed to be constructively failing to offer LZSCs?'.

On that basis, we think the most appropriate approach for Ofgem to take will be to place an obligation on suppliers to offer LZSC tariffs that, in the judgement of the supplier, maximise the attractiveness of the tariff to its customers subject to the supplier having a reasonable expectation of recovering its costs plus a reasonable return. If challenged by Ofgem, the supplier should be prepared to justify its decision, but it should not be deemed to be non-compliant unless it has made modelling or other assumptions that are manifestly unreasonable. A key feature of this approach is that suppliers should be able to take into account their individual circumstances (including their mix of customers) in making their assessment. As experience accumulates as to what works well, suppliers can be expected to learn from market outcomes and sharpen up their offers over time.

Rationale for intervention

As we have stated previously, we disagree with Ofgem's rationale for intervening in this way. Indeed, Ofgem's recent omnibus consumer survey shows that consumer views on how best to structure costs are divided and affordability is a top priority.[1] Respondents

[1] Domestic consumers' views on energy pricing | Ofgem

shared a strong desire to create a 'fair' system that protects consumers in vulnerable circumstances. However, Ofgem's proposal to mandate LZSC tariffs will allow some households to pay less towards system costs, meaning that other consumers must pay more.

Suppliers are already offering smart solutions that reduce overall system costs – meeting consumer preference for control while reducing system costs and helping improve affordability in the round.[2] We encourage Ofgem to consider incentivising innovation rather than mandating specific tariff structures, which may not suit all customer segments or supplier business models. Ofgem is framing LZSC tariffs as a way to give consumers more choice and control. However, this takes the focus off DSR initiatives, which can take the form of innovative smart solutions as well as tariffs. Combining a LZSC tariff with cost-reflective DSR incentives such as turn-up could lead to unmanageably complex incentives for households, with the result that innovation is weakened.

In our view, policy measures that will recover more costs from vulnerable households are ethically and politically problematic. There is a risk of public backlash if Ofgem mandates LZSC tariffs that allow second home owners and those who are able to invest heavily in low-carbon technologies to pay less than their fair share. Our assessment suggests that opposition to standing charges is partly a result of a highly effective media campaign and the level of focus that has resulted from this campaign risks being a distraction from more effective ways to help households, such as targeted support for vulnerable consumers and other measures to address the extraordinary increase in debt levels.

Next steps – need for a policy consultation

We remain committed to supporting a fair, competitive, and consumer-focused energy market. We believe that the best outcomes for consumers will be achieved through collaborative regulation, market-led innovation, and targeted support for those most in need. We urge Ofgem to publish a more detailed Policy Consultation, that considers the timescales of system development (which in our view could well be significant depending on the chosen design) and the factors in the costs of additional complexity and uncertainty, as well as an Impact Assessment ahead of its planned Statutory Consultation to enable meaningful stakeholder engagement on this significant intervention. While this working paper is a helpful step in engaging with stakeholders, working papers such as these should not be viewed as replacements for full policy consultation.

Yours sincerely,

[redacted]

[2] These smart solutions do not generally include zero standing charge options due to commercial viability at the present time.

Annex 1

MANDATING LOW OR ZERO STANDING CHARGE TARIFFS WORKING PAPER – SCOTTISHPOWER RESPONSE

1. Do you have any views on other options to increase customer control over their bills, including innovative payment methods such as variable recurring payments?

We support the exploration of innovative payment methods, including Variable Recurring Payments (VRPs), as a means to enhance customer control and flexibility. However, we believe such innovations should be market-led and developed collaboratively with industry and consumer groups to ensure they are accessible, secure, and meet diverse customer needs. VRPs are still relatively new and not widely supported by all banks or merchants. As such, suppliers would need to invest in infrastructure and training to support VRPs, which may be costly and complex, and consider what additional information and actions are required to educate customers about how and when payments are taken.

We also recommend Ofgem considers the role of smart tariffs and smart solutions, real-time usage insights, and behavioural nudges in empowering customers.

2. Do you have any views on how the level of standing charge reduction could be set?

We support Ofgem's proposal to allow suppliers to offer a 'low' standing charge tariff instead of a zero standing charge tariff. This would reduce a supplier's financial exposure if it misjudged its tariff design, and could make it easier to reconcile the two competing objectives, that the tariff should not be loss-making for suppliers, and should be sufficiently attractive for customers. It would also be consistent with Ofgem's recent consumer research, which showed that when customers were presented with information on the impact of reducing or increasing standing charges on unit rates, only 11% wanted to fully remove standing charges (with 25% wanting to increase them),[3] with the majority preferring a small decrease in standing charges.[4]

Ofgem suggests (para 3.4) that the maximum standing charge could be set by Ofgem at the average level of 'pass through' costs incurred by a supplier, meaning that suppliers only have to recover their fixed operational costs via the unit rate. Table 1 below shows how this would look based on Period 14a cap levels. The pass-through costs are calculated by subtracting the opex element of the nil kWh cap, which is £74.41 for electricity and £96.27 for gas (ex VAT). The simple average across the fourteen regions inclusive of VAT is £136, made up of £118 for electricity and £18 for gas, slightly less than the c.£150 value quoted by Ofgem. (It is unclear whether Ofgem has in mind a simple average or a weighted average (weighted by number of customers)).

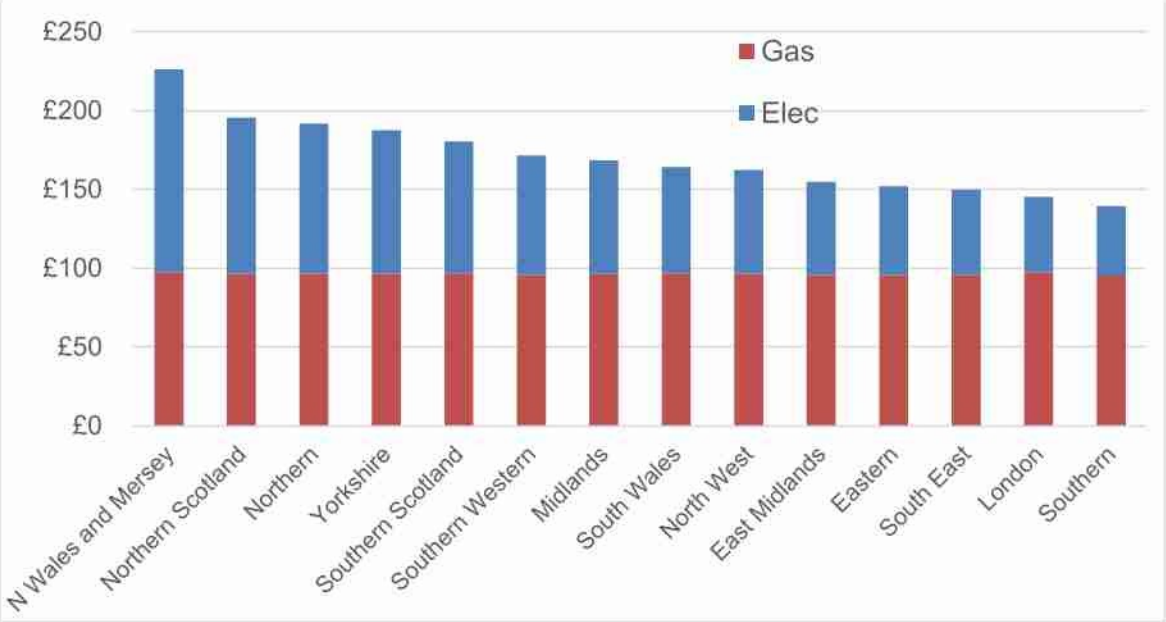
[3] Ofgem Energy System Cost Allocation and Recovery Review, 30 July 2025, para 2.10
[4] Ibid, para 2.11.

Table 1: Period 14A price cap at nil consumption (ex VAT unless stated otherwise)

	Elec (singe rate)		Gas		Dual Fuel	
	Total	Pass-through	Total	Pass-through	Total	Pass-through
North West	£178	£104	£114	£18	£292	£122
Northern	£208	£134	£114	£18	£322	£151
Yorkshire	£204	£129	£114	£17	£318	£147
Northern Scotland	£212	£137	£114	£18	£325	£155
Southern	£157	£82	£112	£16	£269	£99
Southern Scotland	£196	£122	£114	£18	£310	£140
N Wales and Mersey	£242	£167	£114	£18	£356	£185
London	£161	£86	£115	£18	£275	£104
South East	£167	£93	£113	£16	£280	£109
Eastern	£169	£95	£113	£17	£282	£111
East Midlands	£172	£97	£113	£17	£285	£114
Midlands	£185	£110	£114	£17	£298	£128
Southern Western	£189	£114	£113	£17	£301	£131
South Wales	£180	£106	£114	£18	£294	£123
Average (ex VAT)	£187	£113	£114	£17	£301	£130
Average (inc VAT)	£196	£118	£119	£18	£316	£136

Figure 1 shows the amount of fixed costs that will need to be recovered via the unit rate if standing charges are capped at the average pass-through cost. For gas the amount is relatively unform across regions at circa £96 (ex VAT). For electricity it varies from £44 in Southern to £129 in N Wales and Mersey – a factor of almost three. Given that different suppliers have different geographical mixes of customers (ScottishPower has a relatively high proportion in N Wales and Mersey) Ofgem will need to be careful in the way it designs the obligation not to penalise certain suppliers.

Figure 1: Fixed costs to be recovered via unit rate if standing charge capped at average pass-through costs (ex VAT)



We discuss below (in response to Question 11) how Ofgem might formulate the obligation and design a compliance scheme around it, but for the moment we would note that for any LZSC tariff there will be two or three key parameters which determine the commercial viability:

- the level of the 'low' standing charge
- the unit rate uplift (applied either to the first block or to a single rate)
- the size of the first block (if applicable)

If Ofgem caps the level of the 'low' standing charge as it proposes, that is not necessarily a problem, provided that suppliers have freedom to set the unit rate (and first block size if falling block) at a level which best achieves the competing objectives referred to above. In summary, we think it will be far better for Ofgem to allow a low standing charge around the level suggested than to require zero standing charges. This will reduce the risk of tariffs being commercially unviable and improve the chances of tariffs being offered which are attractive to consumers.

Ofgem suggests (para 3.5) that allowing suppliers to offer low (rather than zero) standing charge tariff types may result in them offering single rate rather than falling block variants, as the risk of significant under recovery is reduced. We note that the proposed 'low' standing charges still require significant recovery via the unit rate (Figure 1). An additional benefit of falling block tariffs is that they cap customers' exposure to paying higher bills, eg if their consumption turns out higher than expected or they simply make a poor decision. Even if low standing charges reduce supplier under-recovery and customer over-payment risks, it will still be attractive to suppliers to cap the amount of customer over-payment and hence the risk of complaints from aggrieved customers.

Ofgem should consider that having both a standing charge and block unit rates within one tariff will result in a highly complex offering. This would be more difficult for consumers to understand and for suppliers to implement, requiring careful communication and training. This may necessitate significant system changes, testing, and integration work, potentially delaying implementation beyond Ofgem's current timeline. It is important that this risk is fully reflected in the Impact Assessment, including cost implications and delivery feasibility. We therefore urge Ofgem to adopt a proportionate and consultative approach. This includes engaging more fully with stakeholders ahead of the planned Statutory Consultation.

3. Do you consider a minimum consumption threshold is required to mitigate significant risk premiums or could competitive pressure in the market provide a natural mitigant to ensure these premiums are in line with efficient cost recovery?

Yes, a minimum consumption threshold is a necessary safeguard to prevent gaming by customers and to mitigate under-recovery risks for suppliers, particularly from vacant or second homes.

Allowing suppliers to set a minimum consumption threshold will improve their ability to design tariffs which are not loss-making but still attractive to some customers. In other words, the necessary 'risk premium' or p/kWh uplift to the unit rate will be smaller than without the minimum consumption threshold. This effect is illustrated in the model results in Annex 2.

We think the effectiveness of competition in constraining supplier pricing will depend critically on the revealed (rather than stated) preferences of consumers. If a high proportion of customers genuinely ascribe a 'control premium' to LZSC tariffs, such that they are willing to accept paying higher bills, and this is borne out in the take-up of new LZSC tariffs, we could see a scenario in which suppliers compete on price to retain their own customers and/or

acquire customers from other suppliers. If, on the other hand, consumers behave more rationally, we think LZSC tariffs may become more of a niche offering, with less vigorous competition between suppliers.

4. Do you have any views on how it could be set and what might be the challenges in implementing a minimum consumption threshold?

Setting a minimum threshold

Ofgem, suggests a number of options for setting a minimum consumption threshold:

1. Use of a consumption proxy for primary residence (for example, three months' worth of average annual consumption)
2. Use of a low percentile of annual consumption for the threshold (for example, the bottom fifth percentile)
3. Allowing suppliers discretion to set their own threshold for their tariff
4. Allowing suppliers to exclude non-primary residences based on usage patterns (or other criteria) rather than setting a flat consumption threshold.

We can see a good case for allowing suppliers discretion to set their own threshold (option 3), at least initially, as this will aid the process of competitive discovery of what works best. However, it may be necessary for Ofgem to set some guiding principles to ensure that less responsible suppliers can't evade their obligations and gain an unfair advantage on their competitors.

If Ofgem sets the minimum consumption threshold as a percentage of mean consumption (option 1) or a percentile of a consumption distribution (option 2), it will be important to check that the consumption data is up-to-date, and also to take account of the wide variations in consumption between payment methods.

Table *2* shows how the examples Ofgem gives above would convert into actual consumption thresholds based on DESNZ consumption distribution data for 2023[5]. The table also shows the consumption threshold we assumed for electricity in our modelling results (see Annex 2) and its equivalent for gas. While Ofgem has suggested the bottom fifth percentile in option 2, this would create a threshold significantly below other options that we have considered in our assessment and if Ofgem chooses an approach that sets a specific threshold across all suppliers, we would encourage it to set a threshold at the top end of the range we set out below (ie around the 11th percentile) in order to balance inclusivity with achieving a material improvement in the commercial viability. Setting the threshold lower may mean that fewer households are excluded, but it will also mean that suppliers need to set a higher 'risk premium' making it appealing to fewer consumers with above threshold consumption.

Table 2: Consumption thresholds based on different percentile or % of mean criteria

	Electricity			**Gas**		
	Threshold (kWh)	Percentile	% of mean	Threshold (kWh)	Percentile	% of mean
Ofgem option 2	550	5.0%	17%	1,803	5.0%	15%
Ofgem option 1	801	7.8%	25%	2,985	8.8%	25%
ScottishPower	1,000	10.9%	31%	3,500	11.0%	29%

[5] Subnational electricity and gas consumption summary report 2023, Chart 7, page 13 and Chart 14, page 22

We do not support Option 4 (excluding non-primary residences based on usage patterns) as it would require suppliers to have access to historic daily consumption data. It may be better to allow suppliers to use this as an additional screening criterion, to screen out, for example, larger non-primary residences which may still be above the consumption threshold.

Implementation of a minimum threshold

We agree with Ofgem's assessment around the practical challenges for suppliers in identifying whether customers meet the minimum consumption threshold, although we consider that these challenges are similar to those that suppliers already face when providing information to customers to support informed choices (eg in relation to assessment of time of use tariffs).

We agree that suppliers should be permitted to use AQ and EAC data as the basis of their eligibility criteria. Ofgem rightly states (in para 3.16) that suppliers have access to this data via industry systems, and as we have shared with Ofgem in other engagement, to support consistency and improve consumer experience, we consider this should be used as a default approach by all suppliers when providing estimated annual costs for customers for tariff options, and this would therefore also extend to assessing consumer eligibility for certain tariffs, including any mandated LZSC tariffs.

Inevitably there will be some customers whose circumstances have changed, such that AQ and EAC values no longer reflect their actual consumption at the point of quote, or, as Ofgem notes, customers where actual outturn consumption means that the customer does not meet the minimum criteria in practice. However, we do not think this is a major problem in the overall scheme of things, and we cannot see any realistic alternative. Suppliers must be given discretion in how they assess eligibility, with clear guidance to ensure consistency and transparency. This would include discretion on whether to set the terms and conditions for LZSC tariffs to include how a customer may be removed from a tariff if their consumption falls below the minimum threshold. We believe the existing rules on informed choices within SLC 25 and SLC 0 are sufficient to ensure that where suppliers choose to do this, the terms and conditions that would trigger such a change should be sufficiently clear to customers at the point they choose the tariff. This would be particularly important for any variable LZSC tariffs offered by suppliers.

Ofgem may also need to consider providing guidance on how suppliers should deal with a customer whose consumption is above threshold for electricity and below threshold for gas (or vice versa), who under the current licence conditions (which are separate for gas and electricity) would create circumstances where suppliers would only offer a dual fuel customer the relevant LZSC tariff for one fuel. One option might be to determine eligibility on electricity consumption alone, on the basis that low gas consumption could be consistent with a primary residence (eg with electric heating) but low electricity consumption is less likely to be consistent with a primary residence.

We note that introduction of a minimum threshold creates a more complex tariff including relating to customer communications as well as system development and Ofgem must factor this into the timescales of implementation of any mandated LZSC tariff offering.

5. Do you think that the requirement to offer a low or zero standing charge tariff should only apply to large suppliers, rather than all domestic suppliers? If so, do you have views on how this could be set?

We oppose limiting the obligation to large suppliers only. We agree with Ofgem's assessment (para 3.20) that it would allow smaller suppliers, not subject to the obligation, to avoid offering

loss making tariffs leading to a distorted competitive environment and potential market consolidation. If implemented, the requirement should apply consistently across all suppliers, with proportionate compliance expectations based on size and capability.

6. How might this policy design affect your approach to customer segmentation or tariff design, particularly if you serve either a high proportion of low-consuming customers or vulnerable customers?

Mandated LZSC tariffs will increase financial risk in serving low-consuming customers, who may be in vulnerable situations. Viability will depend on the characteristics of customer portfolios, making flexibility and discretion in threshold setting key to the success of any tariff. This is ultimately a regressive measure that, if not designed carefully, may penalise suppliers with low income or vulnerable customer bases and reduce affordability for those with higher consumption.

In previous work on standing charges, Ofgem has been clear that households with above-average energy needs often include low-income and vulnerable consumers who may be unable to reduce their usage in response to rising costs.[6] Ofgem noted that accurately identifying these households would require enhanced data matching, linking high energy usage with indicators of vulnerability. These customers may be more likely than average to make poor decision around LZSC tariff adoption, with the result that they end up paying more on a LZSC tariff than they would have paid if they had stayed put.

As a former incumbent supplier, we serve a significantly higher proportion of vulnerable households than newer market entrants. Customers in vulnerable situations could benefit greatly from demand flexibility. However, they are often not in a position to invest in low-carbon technologies, such as solar panels, to reduce their consumption and may also face digital accessibility challenges. These differences in supplier customer bases means that the proposed mandatory LZSC tariff risks exacerbating existing competitive distortions that arise from the price cap design. Ofgem's current approach to setting debt-related allowances in the price cap enables some suppliers recover more than their costs, while those serving a more vulnerable portfolio of customers fall short. It is likely that the suppliers who face the greatest risks under the proposed LZSC mandate are the same suppliers who are disadvantaged under the price cap.

We urge Ofgem to consider the cumulative impact of regulatory obligations, including the proposed LZSC mandate, on investment in retail innovation.

7. What are your views on targeting eligibility for low or zero standing charge tariffs to PPM customers as a minimum, or should this be mandated for all payment types?

If Ofgem decides to impose an obligation on suppliers to offer LZSC tariffs, we would strongly support this obligation being limited to PPM customers only, with suppliers free to offer the tariff for other payment methods if they wish. PPM customers face unique challenges with standing charges, meaning that they will likely see greater benefits compared to customers on other payment methods. And customers on other payment methods can switch to a PPM tariff if that is their preference.

If Ofgem decides to mandate LZSC tariffs for all payment types (and we do not consider that it should), we recommend a phased approach, starting with PPM customers and expanding based on market readiness and robust impact assessments. We note that incentivising a move

[6] See for example: Standing charges: domestic retail options

to PPM may be beneficial in terms of reducing debt and simplifying processes for vacant properties. We expect that Ofgem will consider this as part of its scenario analysis.

As previously discussed with Ofgem, we are developing a zero standing charge PPM tariff, as we consider there to be evidence of a consumer need and benefits that outweigh the risks. We do not see the same balance of risks and benefits for other payment methods, and they are not commercially viable at present.

8. What are your views on also targeting eligibility at customers with smart meters?

We would also support allowing suppliers to restrict eligibility to customers with smart meters. This will facilitate monitoring and evaluation of the impacts of this policy and risk management for both consumers and suppliers. For example, smart meter consumption data may make it easier to determine whether suppliers have under or over-recovered. It will allow customers to be aware of the level of their own exposure, reducing the risk of "bill shock". While some consumers may not be eligible for reasons outside of their control as their property cannot have a smart meter, others may be incentivised to opt in for a smart meter as well as an LZSC variant.

9. Would you support the introduction of a review to assess the policy?

Yes. A formal review mechanism is essential to assess the effectiveness, fairness, and unintended consequences of the policy. We recommend a review be conducted within 12 to 18 months of implementation, with clear metrics on consumer uptake, consumer impact, supplier impact, and market dynamics.

If suppliers have been successful in designing non loss-making tariffs, this will mean that a significant number of customers have paid more on their LZSC tariff than they would have done under a normal tariff. Ofgem's review should pay particular attention to this cohort of customers and consider whether in retrospect they are happy to have paid more for this notional benefit of increased 'control'.

10. Would suppliers support regular reporting or disclosure of key tariff characteristics and evidence to demonstrate clear customer communication and active choice to enable market wide monitoring? Is there any other evidence you could provide to demonstrate this outcome that we have not discussed?

We support proportionate reporting requirements that align with existing obligations (as far as possible) and avoid duplication. Any new reporting in the short time periods under consideration should be developed in consultation with suppliers to ensure feasibility and value. We also recommend leveraging existing data sources (eg Ofgem's Consumer Survey) to minimise the burden on suppliers.

11. What practical challenges do you foresee in demonstrating compliance with the low or zero standing charge tariff requirement, particularly in terms of tariff design or communication to customers?

Before considering how compliance with the requirement can be demonstrated, it is necessary to consider what form the requirement will take. Ofgem says (para 2.11) it would introduce new SLCs which require suppliers to have a LZSC offer at all times and in all regions and which set parameters for the introduction of these tariffs. This requirement is then

complemented by two additional outcomes related to tariff design and customer communications (para 2.7) setting the following three outcomes that Ofgem would seek to monitor supplier compliance against if this policy was implemented:

- Outcome 1: Suppliers have available at all times, in all regions, at least one LZSC offer
- Outcome 2: LZSC tariffs are effectively communicated to customers so that they are able to make informed choices about whether to switch to a LZSC option
- Outcome 3: LZSC tariffs are not priced excessively while suppliers are able to recover their costs and a reasonable return.

Outcome 1: Tariff availability

We expect Ofgem will implement new SLCs for this element of the policy proposal.

We agree with Ofgem that this outcome could be monitored using the existing reporting already used to monitor compliance with the price cap. The Customer Account and Tariff RFI includes information on tariff offerings and take-up across all regions and includes information on price and dates when tariffs were offered which should be sufficient for Ofgem's monitoring purposes for LZSC tariff offerings. If Ofgem considers additional reporting to be required (eg including tariff terms such as minimum thresholds if implemented), then it should ensure it be aligned with the existing reporting and suppliers should be provided with sufficient time to update existing reporting.

Outcome 2: Customer communications

Ofgem suggests a requirement that LZSC tariffs are effectively communicated to customers so that they are able to make informed choices.

As Ofgem notes (para 3.33), suppliers already have obligations regarding informed choices in SLC 25 and SLC 0, and we consider there to be a strong argument that these existing licence conditions should be sufficient in the context of a mandate to offer LZSC tariffs.

In particular, given that the commercial viability of LZSC tariffs depends on a significant number of customers making 'poor' choices (in the sense that they do not save money), the focus of any compliance assessment will need to be on whether customers were able to make informed choices rather than on whether they actually did. (Of course, it may be argued that some customers made a good choice, even if they lost money, because of the notional value of 'control', but as we note in more detail below, it is impossible to ascribe an objective value to 'control'). We think the assessment of effectiveness of communications to allow informed choices to be made would need to consider factors such as:

- Were the Principal Terms of the tariff easily accessible to the customer and explained clearly, including the commercial terms?
- Was the quote for the LZSC tariff provided to the customer based on reasonably accurate historic consumption data, with an explanation of the source of the data provided to customers?
- Did the supplier provide some simple guidance to its customers on how they should assess the suitability of LZSC tariffs for their needs?

Ultimately, there may be a tension between the tariff design and customer communication requirements. If Ofgem were to take an approach to existing SLC compliance, or introduce additional rules, that places too many safeguards around customers making informed choices, there could be too few customers making "poor" choices for a LZSC to be commercially viable. We would support safeguards to prevent financially vulnerable customers making very bad

choices (more of a risk with single rate than falling block tariffs) but suppliers should not be expected to discourage other customers from making choices that will incur modest extra costs so long as information is provided that should allow that choice to be informed.

Ofgem says (para 3.34) that it may consider requiring suppliers to "include tariff rates on their website". There is an existing obligation in SLC 31F.11 that requires suppliers to prepare and publish on their website a Tariff Information Label for all Operational Tariffs in a manner that allows easy comparison between tariffs. We would welcome clarification from Ofgem on what it is considering in this context that would not be met by the requirements of SLC 31F.11.

Outcome 3: Tariff design

The current licence conditions do not impose restrictions on tariff pricing, other than in relation to the Default Tariff Cap and the pricing of Deemed Contracts. As such, we anticipate that Ofgem may seek to introduce a new licence condition to support the desired tariff design outcome ('LZSC tariffs are not priced excessively while suppliers are able to recover their costs and a reasonable return'). If this outcome is to be reflected in a SLC, the associated test would likely need to comprise two components.

- The first would assess whether the pricing is excessive in terms of the supplier's ability to recover its costs plus a reasonable return. We think Ofgem could take a similar approach with the existing test for deemed tariffs under SLC 7.3, which states that the "licensee must take all reasonable steps to ensure that the terms of each of its Deemed Contracts are not unduly onerous". SLC 7.4 provides that deemed contract terms may be considered unduly onerous if the revenue derived "significantly exceeds" the licensee's costs of supplying electricity to such premises. Ofgem's guidance on deemed contracts provides further interpretation of this test and Ofgem could work with suppliers to develop guidance specific to the pricing of LZSC tariffs. One relevant consideration might be whether the supplier is able to recover the same overall revenues as would be permitted for the cohort of SVT customers under the price cap.

- The second part is whether the pricing is excessive in terms of the attractiveness of the tariff to consumers, and this is much harder to define. Ofgem says (para 3.35) it is essential that the unit rates are "not so high that the tariffs become unsuitable for most consumers", implying that if the tariff is not suitable for most customers, the pricing would be excessive. We do not think Ofgem can express the test as simplistically as this. For a start, if 'suitable' for consumers means that consumers will save money, it is almost inconceivable that a tariff could allow more than 50% of consumers to save money and allow suppliers to recover costs plus a reasonable return. If 'suitable' for most consumers means that more than 50% of consumers switch to the tariffs, this is again unlikely to be achievable. In one of the scenarios we modelled (falling block, weaker customer decision making, see Annex 2), there was a point on the curve where the tariff was taken up by >50% of customers who engaged (with the supplier still recovering costs) but given known customer inertia it is almost inconceivable that close to 100% of customers would engage.

As an aside, Ofgem suggests (para 3.36) it could follow a similar approach to the FCA's 'fair value' test, but we do not think that this will be of much help here. According to the FCA Handbook (PRIN 2A.4) and guidance, a product provides fair value "where the amount paid by a retail customer is reasonable relative to the benefits of the product."[7] It is difficult to reconcile 'fair value' with the fact that a significant proportion of customers will end up paying more under LZSC tariffs, unless one imputes a value to the additional 'control' that consumers gain. Doing this on an objective basis, suitable for testing compliance with SLCs, would be impossible given current state of knowledge about actual consumer preferences.

[7] https://www.handbook.fca.org.uk/handbook/PRIN/2A/4.pdf

Ofgem says (para 3.37) it recognises the importance of "tariffs that are set at levels that do not strongly disincentivise consumers from the objective of improved choice." Clearly Ofgem will wish to avoid a situation where suppliers make their tariffs unnecessarily unattractive, as a form of constructive non-compliance. But this objective must not be allowed to 'trump' the objective of suppliers being able to recover their efficient costs.

In conclusion, we think the most appropriate approach for Ofgem to take will be to place an obligation on suppliers to offer LZSC tariffs that, **in the judgement of the supplier**, maximise the attractiveness of the tariff to its customers subject to the supplier having a reasonable expectation of recovering its costs plus a reasonable return. If challenged by Ofgem, the supplier should be prepared to justify its decision, but it should not be deemed to be non-compliant unless it has made modelling or other assumptions that are manifestly unreasonable. A key feature of this approach is that suppliers should be able to take into account their individual circumstances (notably the distribution of consumption within their customer base) in making their assessment.

Other operational impacts

Ofgem should carefully consider the financial and operational implications of any additional reporting requirements associated with the proposed mandatory LZSC. While transparency and accountability are essential, the cost of additional compliance and reporting must ultimately be passed on to consumers.

This could also introduce inefficiencies into supplier operations, particularly if the reporting requirements are complex or unclear. Moreover, the introduction of new data queries and compliance checks may strain existing systems and resources, potentially diverting attention from core customer service and debt engagement activities.

A balanced approach is needed to ensure that the benefits of oversight do not come at the expense of affordability or system effectiveness. This is particularly important for a policy measure that Ofgem's recent consumer research suggests has limited public support - when customers were presented with information on the impact of reducing or increasing standing charges on unit rates, only 11% wanted to fully remove standing charges (with 25% wanting to increase them), with the majority preferring a small decrease in standing charges. It is key that the mandatory tariff should not be loss-making for suppliers as this would risk the financial resilience and investability of the retail energy sector.

Annex 2

ZERO STANDING CHARGE ENERGY PRICE CAP VARIANT - SCOTTISHPOWER ALTERNATIVE MODEL OF IMPACT

1. Introduction

This annex presents a model of the impact of different zero standing charge (ZSC) designs on supplier under/over-recovery, and the sensitivity to customer behaviour. This is the same annex as we provided in our 20 March consultation response with minor updates. For simplicity we show the results for electricity tariffs but we have also obtained similar results for gas tariffs. We would be happy to make available an Excel version of the model if that would be of interest. We do not consider low (as opposed to zero) standing charges in this annex, but this option can easily be reflected in the modelling by setting the modelled standing charge equal to the amount by which the standing charge is being reduced.

2. Customer behavioural model

The extent to which a ZSC tariff results in under- or over-recovery for suppliers depends on customer behavioural response. If customers have perfect knowledge of their future consumption and behave rationally, only customers who will save money will opt in to a ZSC tariff and the supplier will always under-recover.

In practice, customers will not have perfect knowledge, may not make optimal decisions and may ascribe an additional value to increased 'control' over their bills, over and above the expected bill saving. To cater for such circumstances, customer behavioural response to price signals can be modelled using an S-shaped function of the form:

$$S_i = 1 - ERFC\left(\frac{b_i + c}{\sqrt{2}\,\sigma}\right)/2$$

Where:

ERFC(x) is the complementary error function in Excel[8]

S_i is the proportion of customers with consumption level *i* who opt in

b_i is the actual bill saving for customers with consumption level *i* under a ZSC tariff

c is the additional value that customers ascribe to 'control' over their bills

σ is a measure of non-perfect decision making by customers.

For our purposes, we are most interested in the *relative* proportions of customers with different consumption levels and bill savings who opt in, since this is what determines whether a supplier over or under-recovers. The modelled values of S_i represent a maximum that would be achieved if all customers engage with the possibility of opting in to a ZSC tariff. If only 50% of customers engage, all the values of S_i will be scaled by 50%, and any financial impacts for suppliers will be scaled accordingly.

Various factors will influence the value of parameter σ including customers':

- uncertainty regarding future consumption (which may change, for example, with changes to household circumstances, year to year weather variations, and installation of insulation measures)

[8] The error function ('erf') is proportional to the area under a normal (Gaussian) probability distribution (see Error function - Wikipedia) and is generally an appropriate basis for modelling random processes such as customer decision making. The scaling factor of √2 is to make σ correspond to 1 standard deviation.

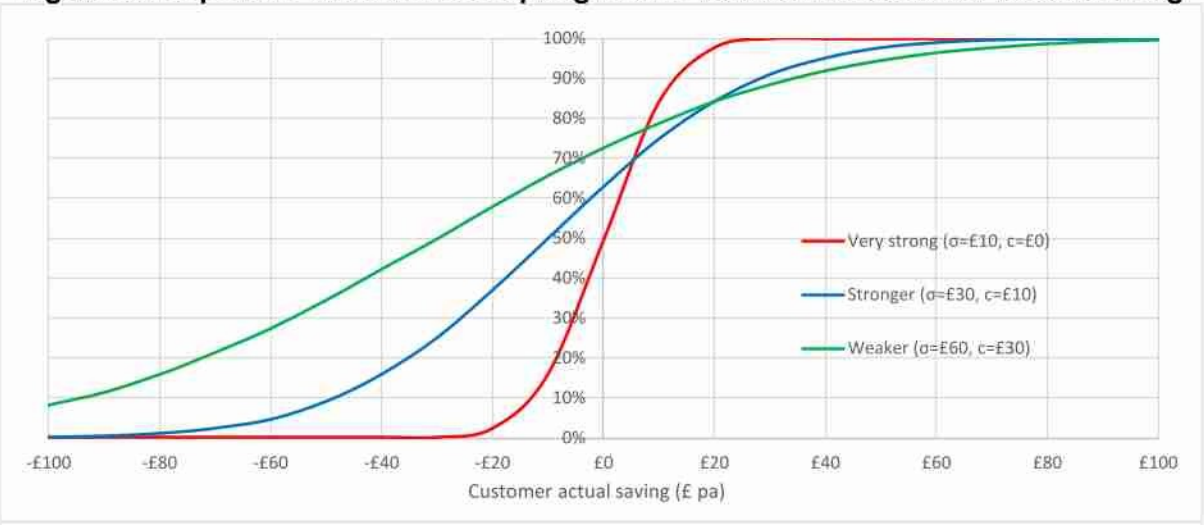
- optimism bias regarding potential to reduce consumption
- risk aversion regarding higher than expected consumption
- poor understanding of how the tariff works
- poor numerical or decision making ability
- quality and availability of third party advice

It is reasonable to expect the value of σ to reduce over time as third party advice websites publish recommendations and customers become more aware of this advice. Similarly, even if customers initially attribute a material value to 'control', we would expect this value to decline over time as customers become more familiar with the impact of ZSC tariffs on their bills and focus more on the actual bill saving.

Figure 1 illustrates the modelled customer response for three combinations of customer decision making parameters, notionally labelled as weaker, stronger and very strong. These are chosen to be subjectively plausible but are not based on evidence of actual customer behaviour. As noted below, a key recommendation is that Ofgem proceeds cautiously with implementation of zero standing charge tariffs with the primary objective of initial trials being to gather some insight into the values of 'σ' and 'c'.

Customer decision making	σ	c
Weaker	£60	£30
Stronger	£30	£10
Very strong	£10	£0

Figure 2: Proportion of customers opting in as a function of customer actual saving



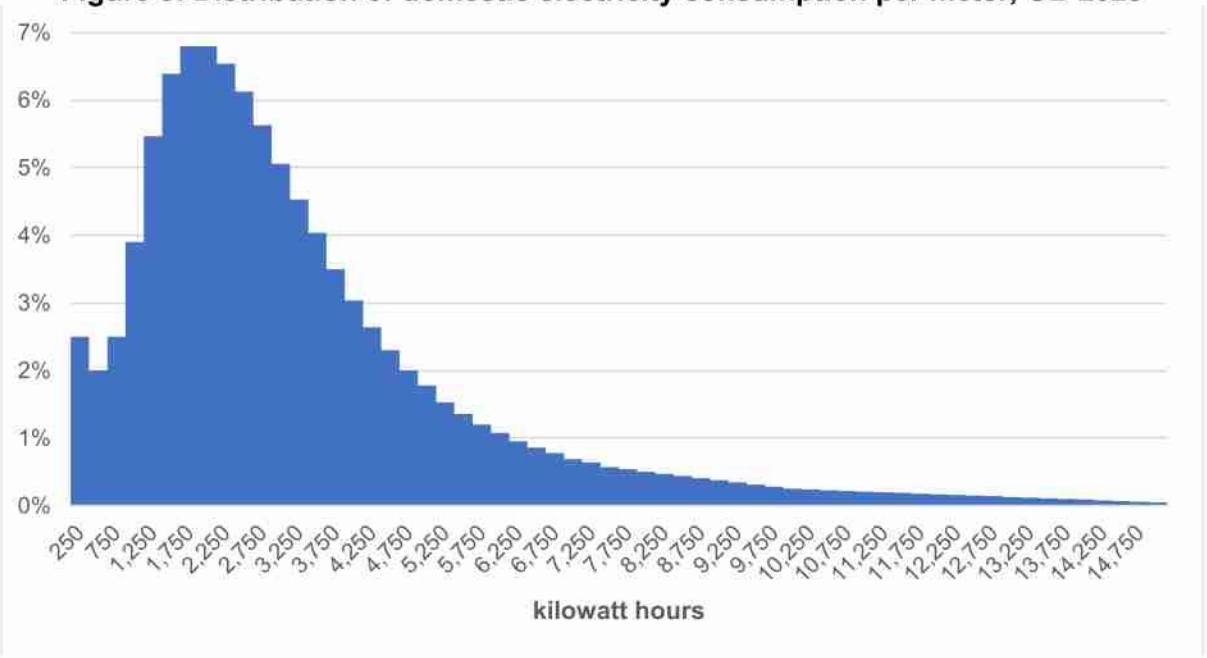
3. Consumption distribution

The distribution of consumption amongst the population of customers is a critical input to the assessment of under/over recovery. We assume an electricity consumption distribution as shown in Figure 2 below, taken from DESNZ statistics.[9] The chart shows the percentage of customers broken down by 250 kWh consumption bins. The mean consumption is 3,301 kWh and the median 2,533 kWh.

[9] Subnational electricity and gas consumption summary report 2023, Chart 7, page 13

The DESNZ data includes all meter types and payment methods and so the results may not be representative of individual suppliers who may have different customer mixes with different consumption distributions. For example, prepayment customers generally have significantly lower consumption than DD customers, so suppliers who have a high proportion of PPM customers may have a correspondingly lower consumption distribution. Also, if multi-rate meters or tariffs are excluded from eligibility, this will also change the distribution.

Figure 3: Distribution of domestic electricity consumption per meter, GB 2023



4. Tariff definition

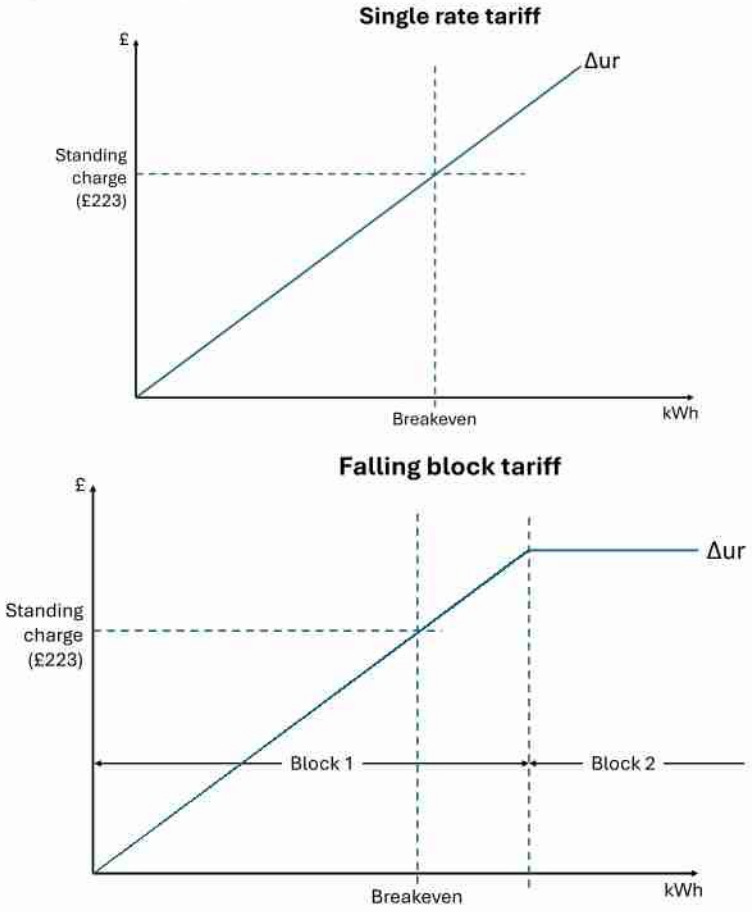
We define single rate and falling block ZSC tariffs in terms of two parameters:

- break-even consumption in kWh;
- the size of Block 1 in kWh (set to a suitably large value to model single rate ZSCs)

The current electricity standing charge is £222.55 inc VAT.[10] The p/kWh unit rate uplift ('Δur') is equal to the standing charge divided by the break-even consumption and is applied to the single rate tariff or Block 1 of the falling block tariff. This is illustrated in the diagrams below, which for simplicity omit the underlying 25p/kWh unit rate[11] which applies pre-uplift.

[10] Period 13b, Jan-Mar 2025, DD post-levelisation, inc VAT
[11] Period 13b, Jan-Mar 2025, DD, inc VAT.

Figure 4: Single rate and falling block tariff structures



5. Model design

We model the financial impact on suppliers in the following steps for a given ZSC tariff design and customer behavioural parameters:

1. Calculate the bill saving (positive or negative) at the midpoint of each consumption bin.

2. Calculate the proportion of customers opting in for each consumption bin as a function of bill saving 'b', value of control 'c' and decision making parameter 'σ' (as described in section 2 above).

3. Calculate the supplier under-recovery for each bin: this is the product of the bill saving multiplied by the proportion of customers opting in and the size of that consumption bin.

4. Sum over all consumption bins to get the average under-recovery per customer.

5. Multiply by 1 million to get the impact per million customers and multiply by -1 to express it as over-recovery.

For simplicity, our model is based on an annual block tariff rather than a quarterly block tariff and supplier under-recovery may therefore be slightly greater than modelled.[12]

[12] This is because of seasonal variation in consumption. A customer's consumption may exceed the first block on an annual basis, but it may fall short of the first quarterly block in summer quarters.

6. Model results

The charts below show, for different tariff designs and customer behavioural parameters, how a supplier's over-recovery varies as a function of breakeven consumption. (As noted above, the p/kWh uplift Δur is equal to the standing charge divided by the breakeven consumption, so low breakeven consumption implies high Δur and vice versa). The charts also show how the proportion of customers opting in to the tariff varies with breakeven consumption.

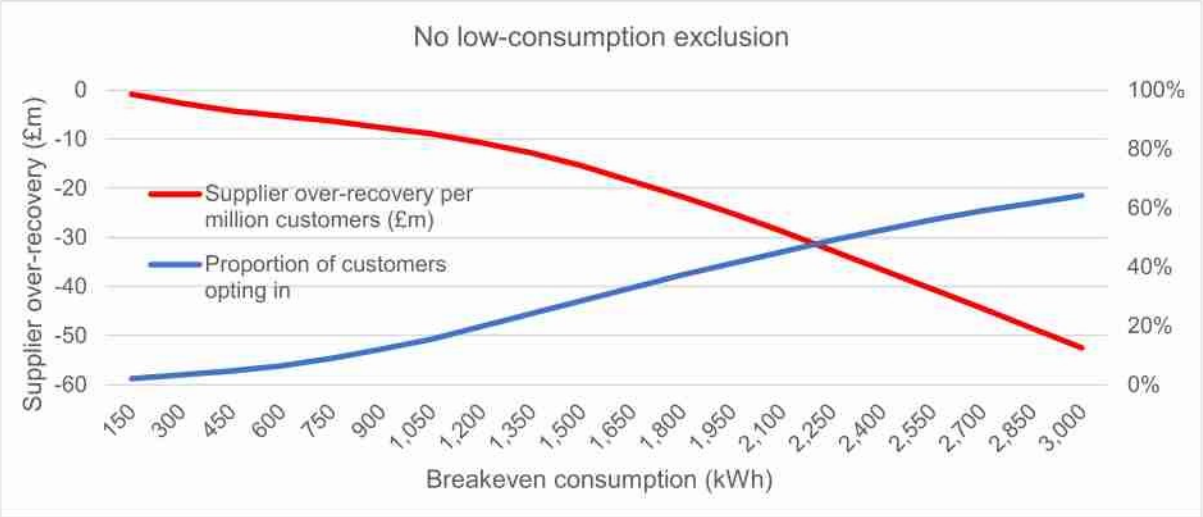
In each case we show the results with and without exclusion of low-consuming customers. In the exclusion version, we assume customers with consumption <1,000kWh (approximately the first decile) are excluded.

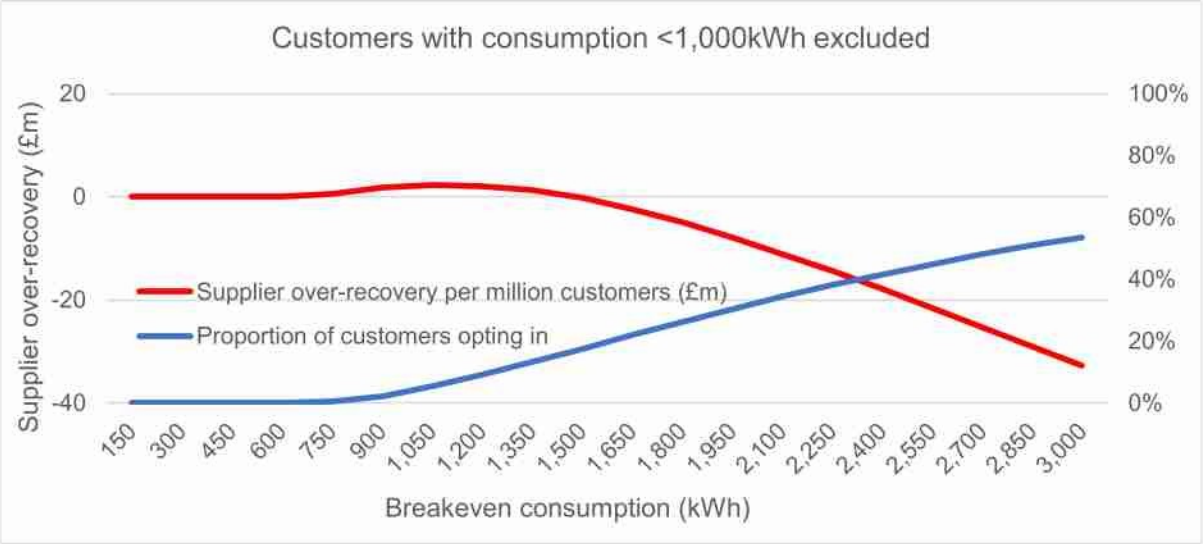
The table below summarises the conclusions that can be drawn from the charts.

	Single rate	**Falling block**
Weaker customer decision making (σ = £60, c = £30)	Single rate tariff not viable at any level of breakeven consumption/ unit rate uplift. Viability improves slightly if first decile of low consuming customers are excluded: slight over-recovery for breakeven consumption around 900-1,350 kWh, but with only modest customer opt-in (~15%)	Falling block tariff just viable for breakeven consumption in range 375-675 kWh and with reasonable customer opt-in (15% to 70%). Excluding low consuming customers enables slightly greater over-recovery with slightly fewer customers opting in.
Stronger customer decision making (σ =£30, c = £10)	As above but slightly worse in terms of supplier under-recovery, reflecting stronger customer decision making	As above but slightly worse in terms of supplier under-recovery, reflecting stronger customer decision making. Falling block only viable at one breakeven consumption (600kWh, corresponding to unit rate uplift of 37p/kWh), with 23% customer opt-in. Excluding first decile of low consumers improves viability, yielding modest over-recovery at 600 and 675kWh breakeven.

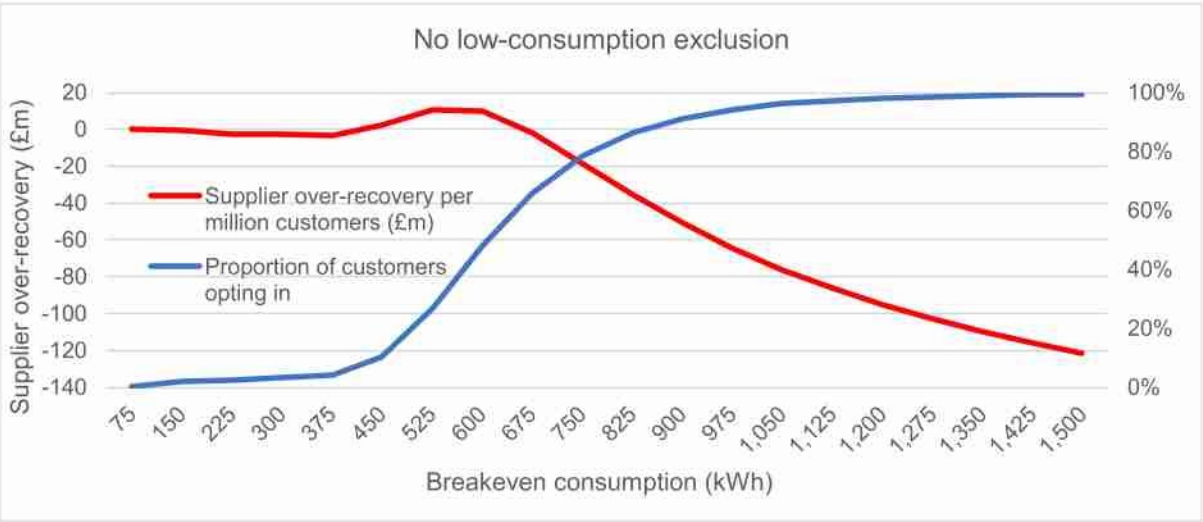
The key reason why falling block tariffs are more viable than single rate tariffs is that customer losses are capped if their consumption exceeds the breakeven consumption. This means that a much higher proportion of customers with higher consumption opt in (according to our behavioural model) and this higher opt-in rate more than compensates for the lower over-recovery per customer.

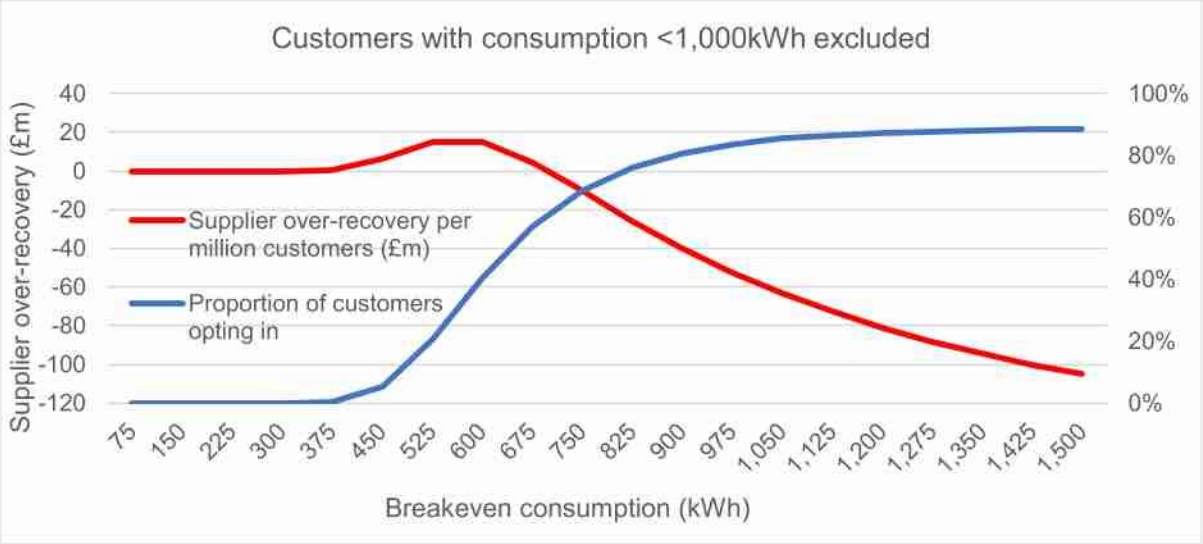
Single rate ZSC, weaker customer decision making (σ = £60, c = £30)



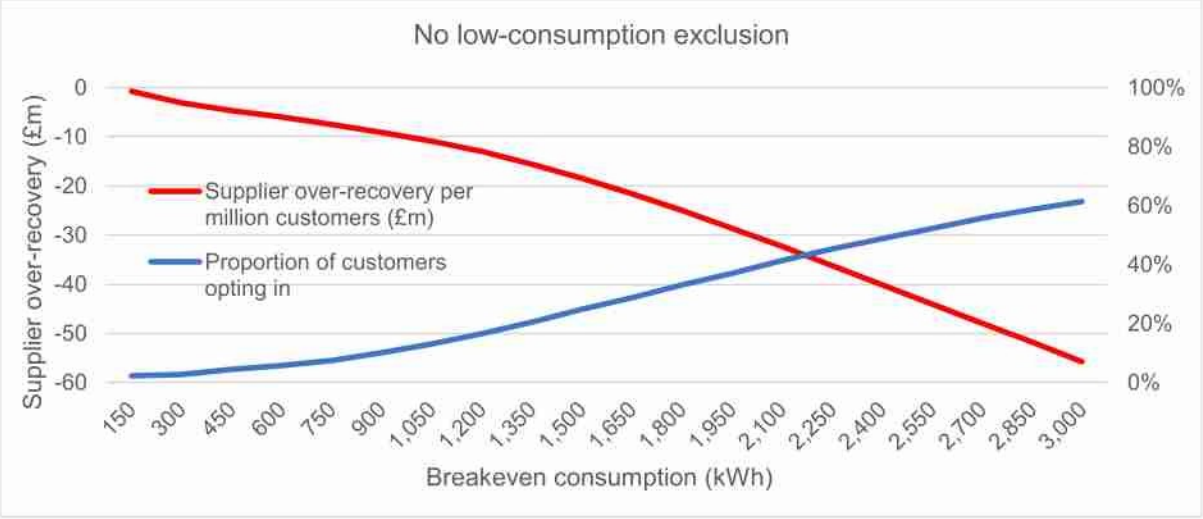


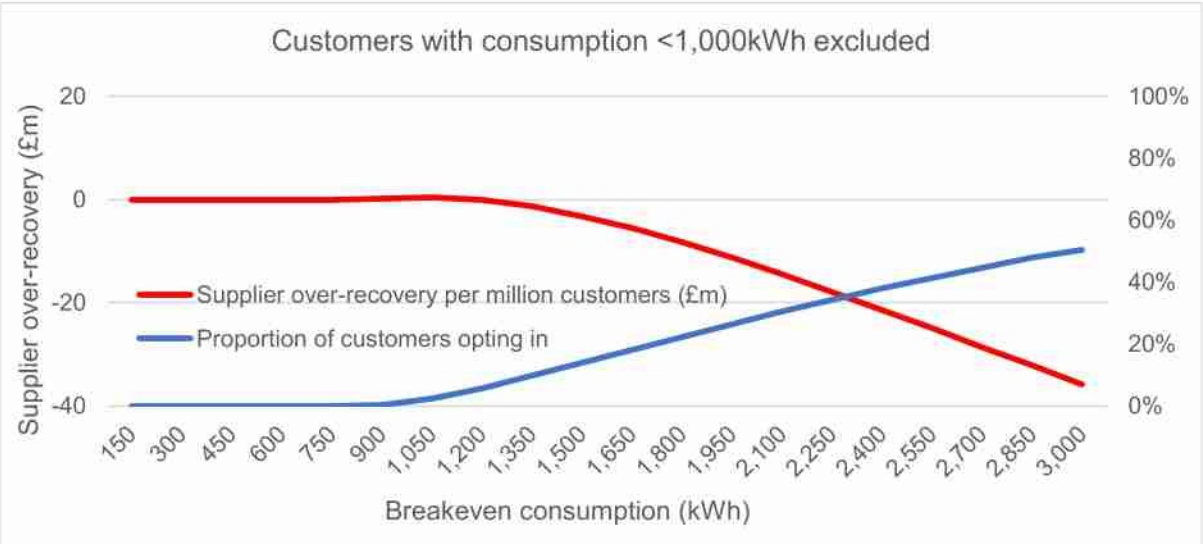
Falling block ZSC, Block 1 = 700kWh, weaker customer decision making (σ = £60, c = £30)



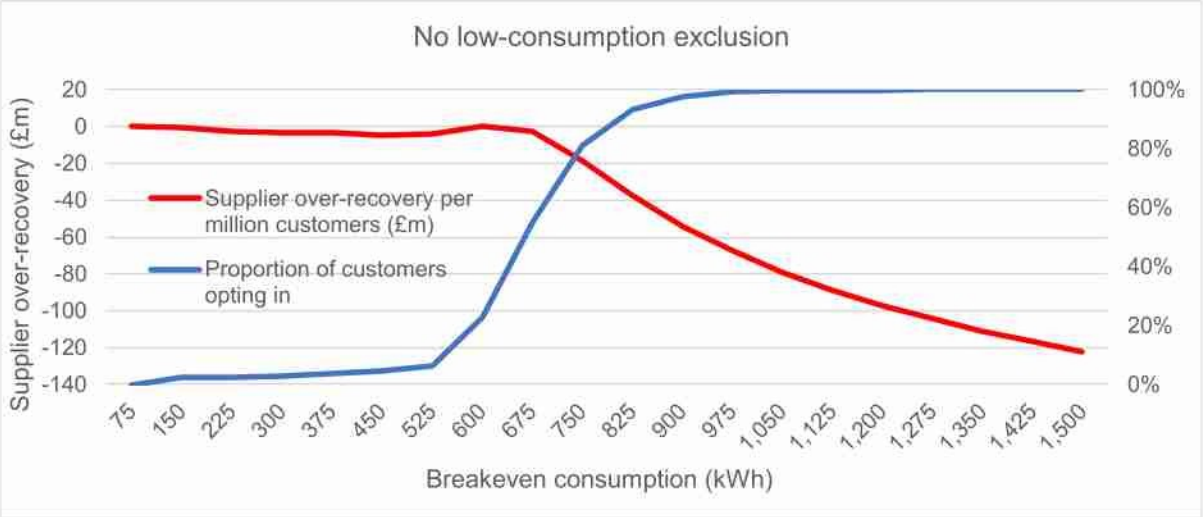


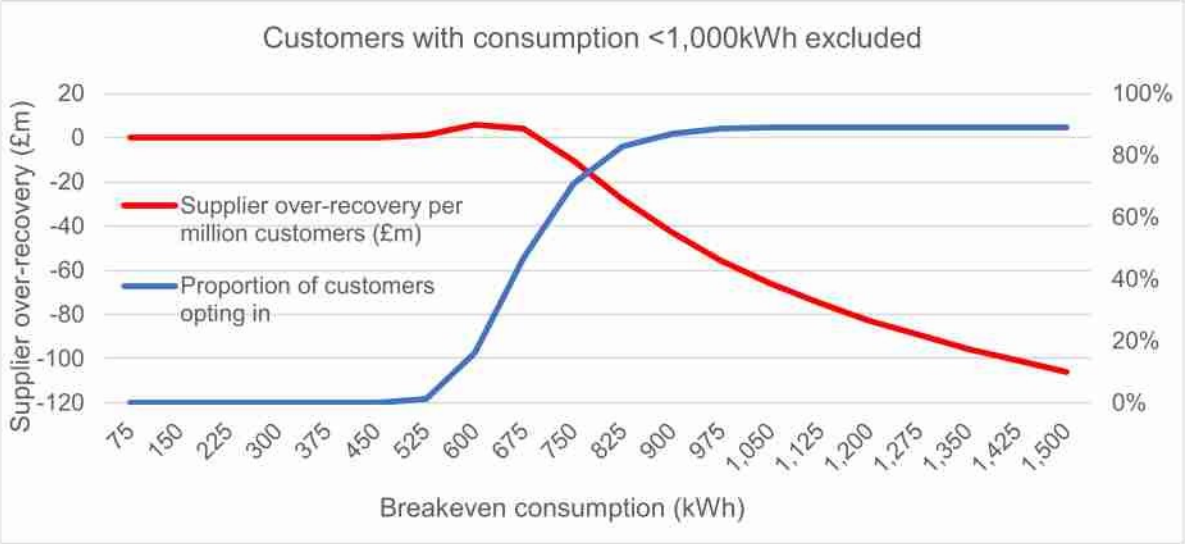
Single rate ZSC, stronger customer decision making (σ = £30, c = £10)





Falling block ZSC, Block 1 = 700kWh, stronger customer decision making (σ = £30, c = £10)





7. Conclusions

Our modelling approach represents a significant step forward from Ofgem's modelling in two key respects. First, it attempts to model actual customer decision making in terms of intuitively reasonable behavioural parameters rather than simply positing an illustrative customer response. Second, by adapting customer response to changing tariff parameters, it avoids the problem whereby Ofgem's 'recycling' of under/over-recovery into a new unit rate fails to take account of the fact that changing the unit rate will change the customer behavioural response.

Although our model uses what we consider to be reasonable estimates of behavioural parameter values, they are not based on any evidence from actual customer observations, meaning the results are still subject to considerable uncertainty. This uncertainty can only be resolved through well designed trials.

Nevertheless, we believe there are a number of important insights from the modelling which are likely to hold true for different behavioural assumptions. While this analysis focuses on electricity, we would expect broadly similar findings for gas.

1. A single rate ZSC tariff is unlikely ever to be viable in the sense that it allows suppliers to avoid under-recovery in a reasonably robust way. Single rate tariffs may just about be viable if a sufficient proportion of low consuming customers are excluded, but this comes at the cost of low customer opt-in rates.

2. Falling block tariffs are more viable than single rate tariffs because customer losses are capped if their consumption exceeds the breakeven consumption. This means that a much higher proportion of customers with higher consumption opt in (according to our behavioural model) and this higher opt-in rate more than compensates for the lower over-recovery per customer. Falling block tariffs are most likely to be viable with weaker customer decision making and/or exclusion of low consuming customers. However, even falling block tariffs may not prove to be viable once wider factors are taken into account, hence the need for Ofgem to proceed with extreme caution if it decides to progress this initiative.

3. The viability of a tariff is highly sensitive to the breakeven consumption and corresponding unit rate uplift. In general, a tariff is most likely to be viable where the breakeven consumption is somewhat less than the mode of the consumption distribution (circa 1,750 kWh of electricity in the DESNZ data), since the number of customers who over-contribute will be maximised and will be better able to offset the under-contribution of lower consuming customers. Ofgem will need to pay close attention to this in any ZSC tariff design.

4. Finally, our modelling shows that there is far greater down-side risk for suppliers than upside risk. In each of the scenarios modelled there is (at best) a narrow range of tariff parameters which results in modest over-recovery but a wide range of parameters which result in very severe losses. This underlines the case for caution.

ScottishPower
August 2025