

Mandating lower or zero standing charge tariffs: A technical working paper

Summary

Utilita has offered a zero standing charge tariff for prepayment customers since 2007. We have explained the structure of this tariff to Ofgem and highlighted the specific appeal to prepayment customers for such a tariff.

Our feedback through the prior stages of this consultation has been consistent – Ofgem must not seek to mandate the provision of such tariffs and instead should ensure that the market conditions exist for Suppliers to offer one if they choose to do so.

If customers are truly motivated to move to a low/zero standing charge tariff, our product exists for them to do so. If such a product exists and customers are not switching, Ofgem should question the validity of what they believe customers want. If customers are not revealing their preferences through switching, then perhaps Ofgem's research is flawed.

If there is a strong customer demand for these products to be offered by every supplier, then Ofgem must consider why Suppliers are not offering such products. Utilita has already highlighted the issues the SVT cap presents to zero standing charge tariffs. With ~65% of customers on SVTs, Ofgem cannot expect most suppliers to be motivated to introduce such a product.

If Ofgem have already committed themselves to intervention, for political reasons rather than economic, then they should introduce a price cap variant of such a tariff. The current SVT cap does not allow Suppliers to recover costs; due to the way the legislation requires costs to be allocated to standing charges.

We are disappointed to see that Ofgem is instead considering requiring Suppliers offer a non-price capped low/zero standing charge product. Ofgem is going so far as to consider that Suppliers should offer such a product for prepayment customers only. Ofgem's justification for making it prepayment specific repeats the exact case we described to Ofgem in earlier stages of this consultation.

Ofgem have taken our feedback from previous consultations and are now seeking to require all Suppliers to offer a direct competitor to our leading tariff. Our feedback was not provided for Ofgem to ignore the recoverability issues we presented, and to instead produce proposals which risk undermining our commercial position. We have been able to offer this zero standing charge tariff (forsaking c.£34 million in revenue since 2020) because we have the commercial advantage of this being a unique selling point, attracting a stable customer base. Without this unique advantage, we would not have been able to offer such a tariff. Our ability to absorb this under-recovery of costs has been made ever more challenging due to the overall level of the price cap being too low.

We are not requesting that our product is protected. We fully support open competition in the sector, and we have no issue with Suppliers offering identical or competing products to our own. Our issue is that Suppliers are not choosing to do so – they are being forced to do so. Ofgem state that they are disappointed more Suppliers have not already offered such products, yet do not appear to consider why they have not done so.

This is the latest example of Ofgem harming investability in the sector. This is a direct interference in competition in the sector, done in such a way to ignore issues introduced through previous Ofgem interventions.

We have little confidence that Ofgem will do anything other than continue with these proposals. We have no evidence of Ofgem ever choosing not to intervene once policy development is this advanced.

Ofgem published their Cost Allocation Review less than a week ago. This is a welcome review and one we will certainly be assessing and providing feedback to. Said review is focussed on how to allocate and collect system costs throughout the entire supply chain. The primary conclusions from such a review must take the form of how to allocate and ensure consistency in recovery of specific charges to either fixed or volumetric charging. This is a clear opportunity for Ofgem to restructure the costs which suppliers are required to pass on (use of system, policy costs etc.) and thereby make a zero standing charge product much more viable for suppliers to offer. It would seem sensible to wait until the outcome of this cost allocation review before progressing with zero/low standing charge proposals.

Updated Approach

Q1. Do you have any views on other options to increase customer control over their bills, including innovative payment methods such as variable recurring payment?

We are in the late stages of implementing a variable recurring payment product. We expect it will go live before the end of this year.

We are hesitant to provide too much detail to Ofgem about this product.

In identifying customer needs and designing products to cater for them, the interests of both customers and suppliers are met. Customers get a product they want – one which better suits their needs. Suppliers gain these customers. This is a positive outcome for both parties. If we provide insight and detail to Ofgem we are concerned they will provide this to our competitors and require they offer identical products – thus removing our incentive to design new products.

Setting a lower standing charge

Q2. Do you have any views on how the level of standing charge reduction could be set?

Ofgem has already recognised one obvious approach, which is assigning all nil-consumption costs to standing charges. This is as simple as setting any fixed costs (third party or Supplier) to standing charge and any variable costs to unit rate. Ofgem anticipate that this will result in a standing charge of £150 per customer.

The recently opened Cost Allocation and Recovery review has the potential to increase or decrease this £150 figure. Ofgem must ensure that whatever principles are applied through this policy are mirrored in the Cost Allocation and Recovery review. Without further change, we would expect this £150 to increase significantly over the coming years.

Any reduction below this £150 level would require minimum consumption thresholds to be set – as low consuming customers would become loss making.

Minimum Consumption Threshold

Q3. 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?

Ofgem cannot expect competitive pressures to play out in a product space which they have intervened to create.

Utilita has not required a minimum consumption level for our zero standing charge tariff to date. Our niche has allowed us to gain enough customers to compensate for those that are loss-making. Ofgem cannot account for these customers in the same way, as they will have to assess the viability of these tariffs in isolation. They can make no assumptions about offsetting losses through individual suppliers gaining market share – as they are proposing these tariffs will be offered by all Suppliers.

A minimum consumption threshold will be necessary if Suppliers are to offer tariffs with standing charges below their costs incurred at nil-consumption.

Q4. Do you have any views on how it could be set and what might be the challenges in implementing a minimum consumption threshold?

Suppliers should be free to set their own minimum consumption thresholds. Ofgem must allow Suppliers to assess the recovery risk themselves and produce products which they consider viable.

If Ofgem is concerned that this level will not be suitably attractive for more customers, then they are recognising that these products are not viable for most Suppliers. The only alternative is Ofgem believe Suppliers are deliberately pricing at inflated prices so as to be unattractive to customers.

Properties that reduce consumption as soon as they are on the tariff are another concern. Suppliers may assess a property as viable using historic consumption, only for the property to subsequently reduce consumption. Ofgem must allow Suppliers to move customers off such a tariff if consumption drops significantly for an extended period.

Supplier eligibility for mandating

Q5. 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?

Supply licence conditions should be applied equally. The principle of only applying certain obligations to larger suppliers distorts competition in the market.

If the products are viable then there should be no need to set this as a requirement only for large suppliers.

If Ofgem want to create a lower initial barrier to market entry, then a time-bound condition could be set. If requiring such a tariff is seen as unattractive or challenging for new entrants, then perhaps Ofgem should consider whether it is appropriate to do so.

Q6. 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?

We will have to produce multiple new tariffs.

We expect any new low standing charge tariff to be more expensive than our current SVT product, as it will need to account for additional cost risks (as we will likely have to offer fixed terms for a minimum of 12 months – whereas the price cap adjustments are more frequent).

We will no longer be able to rely on market share to offset certain loss-making customers. We will likely have to introduce a standard fixed rate SVT product and transition said customers onto this product. We have been able to offer our zero standing charge tariff because we have the commercial advantage of this being a unique selling point, attracting a stable customer base. We estimate we have under-recovered by ~£34m since 2022 by forgoing standing charges (even when accounting for our block tariff structure).

Customer eligibility

Q7. 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?

Utilita already offers a zero standing charge tariff for prepayment customers. It is disappointing that Ofgem has taken our feedback on the structure and merits of our products and is requiring other Suppliers to offer a direct equivalent.

We do not consider that we alone should offer such a tariff. We are not seeking to introduce barriers or fight proposals that would promote competition. All Suppliers should be free to offer whatever tariffs they see fit, and to target whatever customer needs they identify. This does not mean that Ofgem should require all Suppliers to offer all products.

We provided our feedback on zero standing charge tariffs with the goal of highlighting recovery issues. In highlighting these issues, we hoped Ofgem would remedy them and thus make the space more attractive for other Suppliers.

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

We have specialised and been successful through making a falling block tariff work. We believe we have done so in the only viable manner – through requiring a smart meter to be eligible for a zero-standing charge tariff.

It is impossible for some legacy electricity meters to accept a block tariff (they cannot be configured to do so) and no daily usage data is available to perform any reconciliation of usage and charging. We would be strongly opposed to Ofgem requiring us to expand our product offering to legacy customers. We have continuously assessed the viability of doing so and have consistently determined that such tariffs must be contingent on having a smart meter fitted. There are still many customers who are yet to have a smart meter fitted.

Customers must be offered incentives to have a smart meter fitted. Tariff eligibility is one of the key benefits smart meters can offer. We cannot begin implementing operationally and economically inefficient processes to apply smart tariffs to legacy meters.

Change to the SLCs and Review

Q9. Would you support the introduction of a review to assess the policy?

All policy should be periodically reviewed.

The interaction between this policy and the Cost Allocation and Recovery review makes a review all the more necessary.

Compliance approach

Q10. 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 cannot support additional regulatory reporting requirements.

Suppliers already report on every available tariff, rates, multi-tier and multi-rate options for every price cap period. Additional reporting would not be necessary to capture this information. The format and content of tariff information is mandated by Ofgem and any changes to available tariffs would also be subject to these restrictions.

A review of the regulatory reporting requirements is long overdue. Suppliers are subject to a constant cycle of ever-changing reporting requirements.

These requirements are so burdensome as to hamper our ability to innovate and operate efficiently. Our internal system and process designs are effectively led by regulatory reporting requirements. It cannot be the case that the most efficient Supplier processes are those which are inadvertently mandated through over-burdensome and repetitive reporting requirements.

Q11. 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?

Individual Suppliers may disagree with Ofgem as to what constitutes a “low” standing charge tariff. Suppliers may have different views of where the minimum consumption threshold should be set.

Ofgem may assume that low/lower uptake of the tariff for customers of a certain Supplier may indicate a failing by said Supplier. They may adapt their interpretation of what constitutes acceptable communication to meet these assessments.