

Appendix One - Response to consultation questions

Question 1: Do stakeholders agree with our proposed approach to those costs that should be recovered through a standing charge and those costs that should be recovered through a unit rate?

We agree that all fixed costs should be recovered through the standing charge and that all variable costs should be recovered through the unit rate. We do not however agree that the standardisation or regulation of the level of standing charge is either necessary or proportionate. As we set out in our response to the December RMR consultation, Ofgem has not clearly articulated or quantified what the benefits to consumer are of such a policy would be. Ofgem has also failed to undertake a quantified assessment of the costs and unintended consequences of a regulated standing charge. For such a fundamental restructuring of the retail market, we consider this to be a prerequisite of reform.

If Ofgem decide to proceed with their proposals to regulate the level of the standing charge it is important that the definition of costs to be recovered is interpreted sufficiently widely to include all a supplier's fixed costs. This means that any standing charge needs to include all of the elements listed in Appendix 1 of the consultation document, namely: applicable network charges, supplier specific fixed costs such as the provision of metering equipment and the wider cost to serve and environmental programmes such as the Energy Company Obligation (ECO), metering costs and Warm Homes Discount (WHD) expenditure. This point is explored more in response to Question 2.

Levels of fixed costs such as these will vary from supplier to supplier depending on a wide variety of factors, including their business strategy, size, typical customer, throughput and geographic bias. If the standing charge is set at a higher level than a supplier's fixed cost base then a competitive advantage will arise. If the level of standing charge is set at a lower level than a supplier's fixed costs then a supplier will be placed at a disadvantage. In trying to regulate the "correct" level of fixed costs for all suppliers in the market Ofgem will therefore inevitably create significant distortions in the way that suppliers compete for various customer groups.

Even if the standing charge was set at the "correct" level for a supplier, a number of additional adverse consequences are also likely to result from the proposals. These include a focus on price competition driven by standard price comparisons to the detriment of other product dimensions (i.e. wider propositions, or focus on other non-price aspects of competition such as customer service). This will naturally mean that the differential between the unit rates offered by suppliers can be expected to reduce, (as suppliers adjust cost structures to more closely match a level of fixed costs consistent with the regulated standing charge). Given price differentials are one of the largest drivers of switching, there is a strong risk that switching may therefore actually reduce as a consequence of this proposal.

In our response to the "Retail Market Review: Domestic Proposals" consultation we set out a workable set of alternative proposals which avoided these issues. In particular, Ofgem could secure the benefits of tariff simplification and comparability by mandating suppliers to use a standing charge and single rate tariff structure, whilst still allowing them to set the standing charge at the level which reflected their actual fixed costs. When combined with the tariff comparison proposals, this would achieve Ofgem's aims without the negative consequences associated with setting an assumed level of fixed costs through a regulated standing charge.

On a more operational issue, we seek confirmation from Ofgem that the standing charge will be classified as an "energy debt" and that we will therefore be able to continue using existing debt collection and objection processes to secure recovery of it.

Question 2: Do stakeholders have any comments on the proposed broad assessment of the possible elements of the standing charge (set out in Appendix 1)?

As we have set out above, if Ofgem decide to regulate the level of the standing charge, it is vital that they ensure it is set at a level which recovers all fixed costs in order to minimise cross subsidisation between customer groups. This means that a standing charge would need to cover all of the elements listed in Appendix 1 of the consultation document, namely: applicable network charges, environmental programmes such as the Energy Company Obligation (ECO), metering costs and Warm Homes Discount (WHD) expenditure.

Whilst costs arising from schemes such as ECO and WHD should be simple to calculate on a per account basis, we note that there are many variations in, for example, metering costs which Ofgem must factor in to their calculations. Whilst a standard credit meter may cost approximately £22 per annum, whereas a typical prepayment may cost as much as £95 per annum, not including the associated extra infrastructure costs that supplying a prepayment meter involves¹. Suppliers are also incurring significant stranding costs associated with the mandated smart meter roll out. If Ofgem include metering costs generally in the standing charge calculation but fail to either adequately weight them according to the typical mix of meter types in the market or reflect the wider nature of such costs, there is again the risk of significant distortions in the way that suppliers compete for various customer groups.

We also note that a failure to include all fixed costs listed above in the standing charge would both penalise suppliers who have supported energy reduction initiatives to date and decrease the incentives on all suppliers to reduce the energy use of their customer base further. Doing so would simply increase the proportion of loss making customers a supplier had. There is therefore a risk that Ofgem's proposals may act as a barrier to the effective implementation of Government's carbon reduction policy.

All of these issues could be avoided were Ofgem to obligate suppliers to use a standing charge and unit rate tariff structure but allow suppliers to set the level of the standing charge according to their own level of fixed costs.

Question 3: Do stakeholders have any comments on the treatment of regional cost differences? Do they favour Option 1 or Option 2?

As above, we believe that Ofgem should not seek to regulate the prices suppliers charge but should instead seek to set out the framework suppliers operate in, for example by mandating a standing charge and single unit rate tariff structure and allowed the competitive market to innovate within that model. As such we are unable to support either of the proposals Ofgem have developed for treating regional cost differences.

In particular we have significant concerns about Ofgem's proposal to impose a regional adjuster within a national unit rate (Option 1). This would complicate the bill calculation at a time when simplification is sought, essentially replacing today's two-tier tariffs with a new regulated "three tier" tariff. This will be more than simply another line on the bill; it will another element of the tariff which customers have to understand and engage with. It would also be both misleading and confusing to amend the unit rate after a customer has made a comparison of national unit rates.

¹ For example, required payments to the owners of outlets responsible for processing customer transactions.

We accept that regionally set unit rates would be less confusing but this would still mark a significant departure from the December proposals. We note that neither of these regional tariff models formed part of Ofgem's qualitative research prior to the Retail Market Review consultation and as such are entirely untested in terms of customer acceptance and financial impacts. We also argue that Ofgem has not demonstrated such an interventionist approach is required to improve the operation of the competitive market. As an absolute minimum, Ofgem should complete both a qualitative and quantitative impact assessment on these models to assess both whether they are in customer interests and whether the benefits outweigh the costs.

Question 4: Do stakeholders have any comments on the assessment of the individual elements of the possible regional adjuster (set out in Appendix 2)?

Although we believe the proposed definition of a "region" is imperfect we accept that aligning customer regions with the old electricity Public Electricity Supplier (PES) regions is a sensible approach. A pre-requisite for such an approach, as suggested by Appendix Two of the consultation document, is the need to map the gas regions against the PES regions using postcode mapping and then weight the resulting charges depending on coverage.

We are also aware that the degree of alignment between Ofgem and existing supplier based models is likely to vary slightly around the boundaries of regions. Were Ofgem to proceed with such a model, we request that Ofgem make their postcode mapping models available to all suppliers as early as possible and then allow sufficient time for suppliers to implement any systems changes to the way in which the mapping is applied. This will ensure that supplier pricing aligns with any regulated element.

Question 5: Do stakeholders agree with our proposed treatment of the standing charge (based on a broad assessment) and possible regional adjuster (using a formulaic approach) in the licence conditions?

We are concerned with Ofgem's proposal to simply ensure the level of any standing charge is "broadly" cost reflective, without a quantified impact assessment on the consequences any inaccuracies would have on both customer interests and the competitive market. Our expectation is that if Ofgem are to mandate the level of costs suppliers can recover through a fixed charge, a more detailed, formulaic, assessment of the costs needs to be made in much the same way as Ofgem does today for other industry parties such as the Network Owners. We recognise the difficulties associated with ensuring any regulated standing charge accurately reflects the true level of fixed costs in the market, but argue this underlines the need to allow suppliers flexibility to determine their own prices within the regulatory framework set out by Ofgem.

Determining the regulated standing charge through a broad assessment of costs introduces significant uncertainty for suppliers. While we do not support any form of regulated standing charge, to mitigate uncertainty it would be essential that any form of regulated standing charge was determined by a clear and transparent pricing methodology. Regulation of retail prices is unnecessary, however if Ofgem is determined to introduce such a policy, it should do so in a fully transparent way.

In addition, we also call on Ofgem to clarify what process will be put in place to amend the level of the standing charge and / or regional adjuster in future, and in particular, how suppliers will be engaged in the process. Both elements of the proposals would be fundamental to our pricing strategy and thus integral to the way in which we engage with customers. It is therefore critical we are involved in the process.

Question 6: Do stakeholders agree with the proposed timing of any potential changes to the standing charge and possible regional adjuster?

We have no issue in principle with the proposed date of 1st June each year for changes to the level of the standing charge, however we are concerned that the effect of setting pre-defined day for tariff amendments may lead to suppliers changing their unit rates at the same time in an effort to minimise the associated costs of change prices. This would risk undermining customer trust in the market still further by creating the appearance of co-ordinated price changes. This is another reason why suppliers should be free to set a standing charge that reflects their own level of fixed costs.

There is also the risk that if the costs within the standing charge vary at any other time than April each year, for example following a DECC policy change regarding the funding level of ECO, suppliers may not be able to recover those charges through the standing charge for some time. This will lead to further distortions in the level of unit rates. If Ofgem proceed with these proposals, they should seek to mitigate the issues now by providing a mechanism for the level of standing charge to be "re-opened" if certain circumstances arise.

Finally, we believe that, as part of the ongoing efforts to improve customer engagement and improve understanding of why energy bills are rising over time, Ofgem has a role to play in communicating the reasons behind any change in the level of regulated price elements; whether that be the standing charge or any form of regional price adjuster. We would welcome dialogue with Ofgem on how that might best be achieved.