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Dear Andrew,

The Standardised Element of Standard Tariffs under the Retail Market Review

1. We recognise there is a need to improve consumer trust and confidence in the energy sector and believe it is important that energy customers feel positive about their energy supplier. As we highlighted in our response to the Retail Market Review (RMR) domestic proposals, it is because of this that we are making a number of significant changes which improve the transparency of customers' bills and the comparability of tariffs. These include changes to the structure of our tariffs to ensure they are clearly understood by consumers while also consistent with providing a reasonable level of choice.
2. However we do not agree that such an extreme proposal of introducing a standardised and regulated standing charge is either necessary or proportionate. As we set out in our response to the December RMR consultation, Ofgem has not articulated clearly or quantified what the benefits to consumers 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 believe this is a prerequisite.
3. Removing regulated retail prices at the time of market liberalisation delivered major benefits to consumers in terms of price competition and potential to innovate. The reintroduction of a regulated element to retail energy prices will undermine these benefits significantly.
4. We set out our more detailed views on the specific questions Ofgem raises in an annex to this response. However, for the avoidance of doubt, we consider that a regulated standing charge will:
 - **restrict choice** in the retail market;
 - introduce **serious distortions** in the way suppliers set unit prices; and
 - create **confusion and complexity** given the need for regional adjustments to unit prices.
5. For these reasons, we do not support Ofgem's proposals. However, should Ofgem decide to press ahead with these proposals in spite of these concerns, to limit the distortions to competition that would result (at least in part), we would strongly suggest that:
 - standing charges should be set so as to cover all fixed costs to serve (whether they are those regulated by Ofgem and DECC or those supplier specific fixed costs, such as the provision of metering equipment or the wider cost to serve);
 - Ofgem should clarify that the regulated standing charge should be set on an "economic" basis (i.e. to reflect fixed cost to serve) – and not to further any social or environmental policy objectives; and


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- standing charges should be specified and updated according to a transparent methodology (and not according to a “broad assessment”, which would introduce significant pricing uncertainty for suppliers).

Restricting consumer choice

6. Regulating the level of standing charge will remove the ability of suppliers to compete on the basis of different levels of standing charge. This will in turn introduce a direct cost on consumers, given some will prefer tariffs with lower standing charges with higher unit rates (e.g. low consuming customers), and some will prefer higher standing charges and lower unit rates (e.g. high consuming customers).
7. The opportunity for consumers to choose a level of standing charge that best meets their preferences has been recognised as being one of the most important innovations that retail competition has delivered¹. This will be removed at a stroke by these proposals, without the impact on consumers being properly assessed.

Market distortions

8. Standing charges are typically set by suppliers to recover the fixed costs of supplying energy (with variable costs being recovered through the unit charge). Given each supplier has different cost base structures (driven for example by different choices in terms of nature and quality of customer service provided) there is no “correct” level of standing charge that can be set for all suppliers. This means that the policy of introducing a regulated standing charge will, by its very nature, introduce distortions to the way that suppliers set standard tariffs.
9. If the standing charge is set at a level higher than a particular supplier’s fixed cost base then the over-recovery could be used to subsidise a lower unit rate and gain competitive edge; if the level of standing charge is set at a lower level than a supplier’s fixed costs base the under-recovery will lead to higher unit rates. Ofgem’s proposals will therefore inevitably distort the competitive market and lead to cross subsidisation between both customer groups and suppliers alike; creating arbitrary winners and losers. Despite these impacts, Ofgem have failed to provide any quantified impact assessment of these proposals which shows that these costs are outweighed by the benefits.
10. 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.
11. Suppliers may also be more likely to make price changes at similar times under these proposals (as all competitive focus will be on relative positions of unit prices), further dampening switching as well as potentially damaging trust.
12. If, in spite of these concerns, if Ofgem remains convinced a regulated standing charge is necessary to achieve its aims, it is vital that the level of standing charge has no social or environmental policy objectives and that it is calculated to cover all fixed costs. In order to minimise cross subsidisation between customer groups², the standing charge needs to include all costs regulated by Ofgem or DECC such as network charges, social and environmental charges like Energy Company Obligation (ECO) and Warm Homes Discount, as well as any supplier

¹ Professor Stephen Littlechild RMR response, “*Ofgem’s Procrustean Bed*”, p.2.

² An issue identified by Ofgem themselves, RMR December Consultation Document, Table 1.

specific fixed costs such as those associated with the provision of metering equipment or the wider cost to serve.

13. If the standing charge is set too narrowly and does not include these elements, low consuming customers will become loss-making for suppliers, leading to cross-subsidisation by higher consuming customers. This in turn will seriously distort the way that suppliers compete for different groups of consumers. We also note that suppliers have an existing licence obligation to ensure tariffs are cost reflective. It would be perverse to introduce regulation that directly contradicts this obligation.

Confusion and complexity

14. The February consultation provided more details of how Ofgem anticipates the regulated standing charge will be introduced. Given the necessity to introduce regional variation in unit rates (to reflect regional differences in network charges), we believe the proposals will introduce a new set of complexities and confusions to energy bills and price comparisons,
15. In particular we have concerns about Ofgem's proposals to regulate an element of the unit rate (Option 1). A regional adjuster to the unit rate will be more than just another line on the bill, and will add another layer of pricing to tariffs at a time when the industry is moving towards simplification. We also argue that amending the unit rate after a customer has made a comparison of national unit rates is misleading and likely to cause significant confusion for customers.
16. The risk is that this will make customer engagement worse at a time when Ofgem and the industry should be working together to make things better. Neither of the options proposed has undergone a qualitative or quantitative impact assessment and it is therefore unproven as to whether they are wanted by customers and/or will deliver financial benefit. We have serious doubts over both.

Alternative approach

17. In our response to the Retail Market Review (RMR) domestic proposals we set out workable alternatives to these proposals which would deliver increased simplicity in tariff structures without causing the problems and unintended consequences set out above. In particular, we would support a new Ofgem obligation requiring suppliers to structure standard tariffs in a standing charge and single unit rate format (while allowing them to set the standing charge at a level which reflects their specific fixed costs). Suppliers would have the flexibility to compete on fixed costs, cross subsidisation would be avoided and tariffs would be simplified. When combined with tariff comparison tools such as that recently launched by British Gas, we argue that this alternative would not be at the expense of comparability.
18. As set out in our response to the December consultation, we are keen to work with Ofgem to develop a package of reform which delivers genuine improvements for customers. However, we do not believe that a regulated standing charge forms part of this package.

We have set out our detailed answers to the specific consultation questions asked in Appendix One to this letter. I would welcome the opportunity to discuss these points, and how our alternative model of reform may help Ofgem achieve their aims.

Yours sincerely



Tim Dewhurst

Director of Regulatory Affairs, British Gas