

Retail Markets
Ofgem
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The Retail Market Review: The Standardised Element of Standard Tariffs

EDF Energy welcomes the opportunity to respond to Ofgem's consultation paper.

This response is consistent with our response to the main consultation on the Retail Market Review: Domestic Proposals. Our key points were:

- A single tariff structure should be applied to all products and tariffs, not just evergreen;
- There should be no standing charge for electricity and gas, and so consumers would pay just a unit rate;
- Ofgem should set up a clearing house to remove regional variations in domestic transmission and distribution charges, enabling transparent national prices for consumers;
- In the absence of a clearing house, Ofgem should set a regional rate adjuster so that suppliers compete on national unit rates;
- If a standing charge is introduced, then it should be the narrow option.

We agree that there is a need to increase transparency of costs for energy consumers. However, setting an imperfect standing charge based on estimated or approximate costs is likely to reduce, rather than increase, transparency. We believe that transparency would be better delivered through clear communication to consumers of the actual costs incurred by suppliers.

Standardisation of tariff structures would lead to simpler comparisons between competing offers, improving transparency for consumers and enabling better decision making. We believe this would lead to increased engagement in the market and help restore trust in energy suppliers.

We strongly believe that the "single tariff structure" should be adopted such that standardised elements are applied to all tariffs and not just standard evergreen tariffs. It is extremely important that consumers can compare all offers easily in order to give them the best chance of making the right choice for themselves. Without this easy comparison we fear that there is a high risk of different levels of competition emerging, with competition being strongest in the non-standard market, whilst the standard variable market exhibits a lower level of competition.

Given the low level of proposed standing charge if based on pass-through cost, we believe that the simplest approach would be to set a zero standing charge for both electricity and gas. This would enable the simplest possible comparison of prices by consumers. In addition, it would also mean that low consumption consumers paid less per total unit consumed than if a standing charge were applied. This is consistent with our desire for the proposals to protect vulnerable consumers.

The current approach to regional pricing does not provide for simple or transparent comparisons, with inconsistent pricing between regions leading to potentially misleading price comparisons, based on national averages. Therefore, we support the standardisation of regional differences through the introduction of a regional unit rate adjuster that enables suppliers to set national unit rates. This provides the simplest and most transparent price comparison for all consumers, with truly cost reflective regional price differentials applied to all suppliers and tariffs.

Further simplification could be achieved if Ofgem introduced a clearing house for transmission and distribution costs between network providers and suppliers. This would enable the setting of a standardised national charge for transmission and distribution for domestic suppliers and, therefore, for domestic consumers, thereby removing the need for the regional unit rate adjuster.

We believe that Ofgem should undertake a full impact assessment of the proposed tariff options, in order to provide evidence to support the final proposals and identify any amendments that may be required, to mitigate the risk of unintended effects and protect the interests of consumers.

Our detailed response is contained in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries please contact my colleague Paul Delamare on 0207 752 2187, or myself.

I can confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'D. Linford', with a long horizontal flourish extending to the right.

Denis Linford
Corporate Policy and Regulation Director

Attachment

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EDF Energy's response to your 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?

EDF Energy agrees with the proposed recovery through the unit rate of the gas transmission and distribution costs and the electricity transmission and variable distribution costs as shown in Table 2.1.

We disagree with the inclusion in the standing charge of the Energy company obligation (ECO), Warm Home Discount (WHD), metering and other supplier fixed costs. These are not pass-through costs and they vary by supplier and/or consumer. Therefore, we do not agree with their recovery through a national standing charge.

The electricity fixed distribution charge is a pass-through cost. However, it varies by region and its inclusion in a national standing charge would therefore be inaccurate. Given its relatively small value and our proposal to exclude the other elements, we believe the simplest solution would be to set a £nil standing charge for both electricity and gas.

Setting a £nil standing charge for all products should lead to greater consumer engagement as it would reduce complexity for consumers and facilitate the comparison of tariffs and product offerings across standard and non-standard offers.

We agree with the statement in 2.32 that reducing the standing charge should limit the difference in cost per unit between low and high consumption energy consumers and that those with low consumption are also more likely to be low income consumers.

A £nil standing charge, with all costs recovered through the unit rate, would remove the differences in cost per unit, resulting in a low consumption consumer paying the same average price per unit consumed as high consumers.

We recognise that this could lead to potential issues of cross-subsidisation for those costs that are charged on a per account basis between high and low consumption consumers. However, given the small size of a narrow standing charge, any cross subsidisation is likely to be relatively immaterial in the context of the average energy bill.

In addition, we believe that the mechanism for charging consumers for the costs of social and environmental obligations should seek to meet policy objectives in the most cost effective way. By including the cost of obligations within the unit rate, the cost of these programmes could be charged proportionally, based on energy consumption, which would be a fairer basis for recovery of these costs.

Network Costs

We agree that all gas transmission and distribution costs should be excluded from the standing charge, as should the majority of the costs for electricity transmission and distribution. These charges are linked to either actual or historic consumption and should, therefore, be charged through unit rates.

The proposal for one national charge for fixed electricity distribution costs would result in under and over recovery of costs between regions. This provides competitive advantages and disadvantages for suppliers depending on their cost base. Moving the cost to a unit rate basis shifts the under and over recovery of costs between consumers of different consumption levels.

Both methods are therefore imperfect. However, moving the cost to a regional unit rate basis has the advantage of providing a £nil standing charge.

Environmental and social obligations

The costs of the ECO and WHD are not borne by all consumers as small suppliers are exempt from these obligations. Including these amounts in an Ofgem set standing charge would lack transparency and lead to confusion for those consumers who would be charged for a cost that does not apply to their account, and for a programme that their supplier could not deliver to them.

We disagree with the assertion that the estimated higher fixed costs per customer for small suppliers will equally offset the avoided costs of ECO and WHD. If there is data that supports this, then it should be made public.

In addition, environmental obligations such as Carbon Emissions Reduction Target (CERT) and Community Energy Saving Programme (CESP) are based on volume targets. Therefore, it is impossible to accurately predict the actual cost incurred by suppliers for meeting their obligations. This would, therefore, lead to over and under recovery of costs in the charge levied to consumers.

Metering costs

Metering costs also vary by supplier. Ofgem's proposal to base the charge on the regulated meter asset provider (MAP) prices would create under and over recovery of costs for suppliers as:

- Regulated and deregulated meter costs vary. The proportion of regulated to deregulated meters varies between suppliers creating different average costs;

- The regulated prices for electricity meters vary by electricity region. Therefore, the regional mix of customers will affect each supplier's average meter cost;
- The costs associated with reading and maintaining meters will also vary between suppliers.

Other fixed costs

We do not agree with the inclusion in the standing charge of an amount for other fixed costs. Each supplier has different levels of fixed costs and, therefore, a national standing charge will lead to under or over recovery compared to the actual costs incurred. This approach would lack transparency and would risk increasing, rather than reducing, confusion for consumers.

As stated above, we strongly believe that setting an approximated standing charge, based on the proposed elements above, risks increasing consumer confusion and mistrust in energy companies. By contrast, a national unit rate structure with a £nil standing charge, applied to all products and tariffs, would offer the simplest approach, making comparisons straightforward, increasing engagement and protecting consumers interests.

Question 2: Do stakeholders have any comments on the proposed broad assessment of the possible elements of the standing charge?

Most of the proposed elements for the standing charge are not pass-through costs and vary significantly by supplier and consumer. We therefore believe they are not suitable for inclusion in a national standing charge applicable to all consumers.

The electricity fixed distribution charge is a pass-through cost; however the charge varies by region, so its inclusion in a national standing charge would be inaccurate for the majority of consumers.

In proposing the broad assessment of the elements of the standing charge, Ofgem recognises the inaccuracy involved in setting a charge to apply to every consumer. As stated above, we believe that this inaccuracy leads to a loss of transparency for consumers and risks aggravating the low levels of consumer trust in energy prices and suppliers. A £nil standing charge and unit rate structure for all products would be simpler to understand and lead to increased consumer confidence when making price comparisons.

We have responded on each of the five elements in our answer to Question 1 with respect to why we believe they should be recovered through the unit rate rather than the standing charge.

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

We believe the simplest solution for consumers would be to have a transparent national price comparison, which is not clouded by averages across regions. This

would give consumers confidence in the choice process, irrespective of which region they live in, or how much energy they use.

As proposed in our February 2012 response to the RMR consultation, we believe that Ofgem should simplify the domestic energy market by introducing a clearing house to standardise transmission and distribution charges for domestic consumers. This would insulate domestic consumers from the detail of network provider revenue recovery models, which we do not see the need to alter. A national domestic charge for transmission and distribution would remove the need for regional price differences and result in a simple and transparent national market for domestic consumers.

From the options presented, option 1 would see suppliers setting national unit rates with Ofgem setting a regional rate adjuster, whereas under option 2 suppliers would be free to set regional unit rates. Therefore, only option 1 would address the existing issue of non-cost-reflective regional price differentials that have the potential to distort national price comparisons. Therefore, we favour option 1.

We agree that the regional adjuster proposed under option 1 should be based on the regional differences in published transmission and distribution charges. It will be necessary for Ofgem to support suppliers in explaining to consumers what the regional adjuster relates to and why the adjustment is made to the supplier's unit rate in their bill.

We strongly believe that, as with the standing charge, the regional adjuster should be applied to all products and tariffs and not just standard evergreen tariffs; in accordance with the "single tariff structure" proposal. This would ensure the greatest simplification of the market, with comparable national unit rates across all tariffs and products allowing consumers to quickly identify the cheapest offer.

Question 4: Do stakeholders have any comments on the assessment of the individual elements of the possible regional adjuster?

As above, we agree with the proposal to base the regional adjuster on the regional differences in the published transmission and distribution charges for gas and the published transmission and variable distribution charges for electricity.

Our proposal to set a £nil standing charge would move the fixed distribution charges for electricity to be recovered through the unit rate. If the cost is moved to the unit rate the regional differences should also be reflected through the regional adjuster.

We agree with the need to convert the electricity transmission charge and gas capacity charges based on peak consumption or peak load into an 'equivalent tariff' to apply on a p/kwh basis. It is unclear in appendix 2 paragraph 1.10 whether the conversion formulas will use the load factor % and peak share % based on national averages or based on the percentages for each ex-PES area or gas region. We believe these should be calculated separately for each region

using the individual load factor or peak share as this will give the most accurate calculation for the regional adjuster.

We agree with the proposal to prohibit the charging of Independent Distribution Network Operators (IDNO) or Independent Gas Transporters (IGT) premiums to customers and we have already taken action to simplify our tariffs by removing such charges.

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?

Our proposal of a £nil standing charge would remove the need to include a schedule of charges in the licence condition.

We disagree with the proposed inclusion of hard coded monetary values in the licence conditions if Ofgem introduce the proposed standing charge. This approach would limit the flexibility to respond to changes in the underlying costs, for example if the cost of the ECO or WHD obligation increased due to changes in government policy or the market price for delivering measures.

We agree with the proposal to include the regional adjuster in the licence condition using a formulaic approach as this would retain the flexibility to reflect updated rates as they are published. However we believe that Ofgem should commit to publishing the actual pence per unit adjuster for each region, allowing suppliers sufficient time to update their systems.

We propose that changes to the regional adjuster are not required to be notified to consumers separately, as this would add significant costs to suppliers that would need to be passed on and result in higher bills. Notifications would provide little benefit for consumers given that the cost is unavoidable, is determined by Ofgem, and is a uniform charge applicable to all suppliers dependent upon where they live. Ofgem should publish details of the changes on its website and in the national media rather than suppliers writing to every customer.

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

We disagree with the proposal to only update the standing charge and regional adjuster once a year. We strongly believe that any standardised elements should be changed as often as the underlying costs change.

Ofgem have stated that they would monitor actual costs incurred by suppliers and may propose a change if they observe significant mid-year changes to network costs. However we propose that the regional adjuster is not changed for indicative charges by transmission and distribution companies, but is changed to reflect any changes in "final" charges billed to suppliers.

If the adjuster is not changed as often as underlying costs change then Ofgem are likely to inadvertently affect the relative profitability of suppliers as inconsistent changes in regional network charges will not be reflected, impacting competition in the domestic market.

EDF Energy
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