first:utility

April 2nd, 2012

Retail Markets Team
Ofgem
9 Millbank
London
SW1P 3GE

Dear Sir,

<u>The Standardised Element of Standard Tariffs under the Retail Market Review</u>

Please find First Utility's response to your consultation on the above issue below.

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?

First Utility's view is that a single regulator prescribed standing charge for the standard variable tariff is likely to create more issues than it solves. Supply companies operate their businesses with different fixed and variable costs. The concept of a tariff with a fixed element and variable element allows suppliers to allocate fixed costs into the fixed element of the tariff and variable costs into the variable element in a cost reflective manner. If in the future suppliers can only include those charges deemed by the regulator into the fixed element, this will mean other fixed costs need to be recovered as part of the variable element. In order to collect the correct amount of fixed costs in the variable element of the tariff, assumptions must be made by the supplier in relation to the customer's consumption profile, which may or may not be correct at the time an offer of supply is made to that customer. For example, the way AQs are treated in gas supply means that the significant majority of the costs of sales are fixed, irrespective of actual consumption at each site, which equates to a considerable cost per average customer. Therefore, it may be more appropriate to include electricity and gas transmission and gas distribution charges in the standing charge as has generally previously been the case. While we agree that other fixed costs should be contained in the standing charge, metering costs should probably be included in the unit rate as these costs for smart meters may vary between suppliers dependant on the arrangements they have in place for these as regards third party asset owners etc. Any other approach is likely to increase uncertainty around the collection of fixed costs that have been smeared into the variable element of the tariff and would result in suppliers holding an additional risk premium to cover the risk of under collection. This would ultimately result in higher costs for consumers on that tariff.

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)?

Please see our comments in Q1 and in our covering letter. First Utility's view is that costs that are fixed should be contained within the standing charge while costs that are variable should be contained within the unit rate. However, we believe that a regulator prescribed standing charge will make it harder for consumers to determine which tariff offers them the best deal as this approach will make it virtually impossible to compare a standard variable rate tariff with a non standard fixed rate tariff. This is due to the fact that no control is exercised by the regulator as to what elements will be incorporated in the standing charges and unit rates for the latter, leading to a risk that some consumers may become confused as to when comparison of unit rates is sufficient and when it is not. This confusion could then result in consumers inadvertently switching to a more expensive tariff.

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

Please see our comments in Q1 and in our covering letter. If Ofgem proceed with this proposal despite our concerns, we would prefer option 2 as it allows us some pricing discretion to vary prices in different areas on the basis of cost differences within those areas.

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

Please see our comments in Q1 and in our covering letter. If Ofgem proceed with this proposal despite our concerns as discussed in our answer to Question 3 above, our preference would be for option 2 thus allowing suppliers to set regional unit rates themselves and allowing a simpler approach whereby only two tariff elements would need to be considered by consumers. We also note that this would not result in distributional impacts which might significantly increase the cost differentials between the cheapest and most expensive regions.

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?

Please see our comments in Q1 and in our covering letter. If Ofgem proceed with this proposal despite our concerns, although it may be appropriate to use the licence to capture the requirements for the standing charge and regional adjuster (should option 1 be selected by Ofgem) we note that these charges can change more frequently than annually and provision should be made for this.

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

Please see our comments in Q1 and in our covering letter. If Ofgem proceed with this proposal despite our concerns, we would like to reiterate our view that the capacity for annually amending the standing charge and regional adjuster may be inadequate. We would suggest provision for 6 monthly amendment, perhaps on April 1st and September 1st, in order to ensure that suppliers, and particularly smaller suppliers, are not exposed to biannual external charges which can then only be reflected in charges to customers annually.

Please do not hesitate to contact Chris Hill (chris.hill@first-utility.com) or Jonathan Smith (jonathan.smith@first-utility.com) should you have any questions or require any further information.

Best regards,

Chris Hill

Chris Hill

Regulation Manager

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