EXECUTIVE SUMMARY

Retail Market Review: Standardised element of standard tariffs

In our response to the RMR: Domestic Proposals consultation (23 Feb 2012), we argued that the proposal for Ofgem to set the standing charge to be applied to all standard tariffs was a misguided and inappropriate means of increasing consumer engagement. Indeed, SSE believes that this proposal will damage competition and be to the detriment of those customers who are unwilling to sign up to a fixed-term contract (FTC).

In this response, we tackle the particular issues that arise when considering which elements should be included in the standing charge and whether Ofgem is in a position to set a 'standardised' charge to be applied to all standard tariffs. We believe that Ofgem is attempting to tackle too many issues at once, without having properly made the case that the proposal to set the standing charge is an appropriate measure to pursue in the first place.

Ofgem has presented two options for the treatment of regional cost differences. SSE believes that both options have significant downsides that limit the degree to which the proposal to set a standardised charge could contribute towards Ofgem's objective of tariff simplification and improved customer understanding:

- Option 1 could lead to simpler comparisons of tariffs on a national scale, but only at the very significant cost of increased tariff complexity: the introduction of a third element to standard tariffs is completely at odds with the drive towards simpler and clearer communications which is at the heart of the RMR proposals
- Option 2 would not have the same detrimental impact on bill simplicity, however the number of regional prices would make the publication of tariff information on a national basis impractical - it is therefore not at all clear that this option would result in an effective 'nudge' for disengaged customers to review their energy tariff

A weakness of both approaches is that they ignore some regional differences in costs which are fixed in nature, and so would result in standing charges which are neither transparent nor cost reflective.

If Ofgem were to proceed with this proposal, it would impose a single over-simplistic view of fixed costs and cost recovery on all suppliers. This would erode scope for suppliers to take commercial decisions which enhance competition in the standard tariff market (such as the current range of standing charges offered by different suppliers which provide an opportunity for customers to save money).

Setting a national charge (or a charge which underplays the degree of regional variance to any extent) would equate to Ofgem imposing a particular market view on all suppliers, regardless of their size or ability to absorb any cash flow risk that this proposal would entail. This constitutes a significant regulatory risk that will damage competition in the long term.

SSE believes that suppliers should be allowed to set their own standing charges. Ofgem should pursue tariff simplification through more effective means that risk fewer unintended consequences. If Ofgem wish to pursue this proposal, SSE believes that it is premature to attempt to standardise the standing charge before:

- Government schemes are calculated on a unit basis, rather than per customer (which would reinforce the energy efficiency message as well as simplifying suppliers' cost structures)
- identifying a means to recover network costs from suppliers based on a cost structure that is genuinely compatible with the structure of domestic tariffs (it is at best an oversimplification to treat capacity charges as unit based costs)

In this Executive Summary we highlight the areas where we think there are sound reasons for Ofgem to reconsider its proposed approach. We present our responses to the particular consultation questions in the Appendix to this document.

EU Jurisprudence

Under Internal Energy Market legislation, the EU has set out the circumstances under which it may be appropriate for governments or regulators to set end user energy prices. It seems reasonable that the principles which apply to setting the end user energy price should also be taken into account by Ofgem in considering any market intervention to set any element of that end user price. In particular we would highlight the requirement under article 3(2) of both 2009/72/EC and 2009/73/EC that any "obligations which may relate to… price of supplies… shall be clearly defined, transparent, non-discriminatory [and] verifiable." Further clarification of this requirement was issued following the Federutility case (Case C-265/08).

As described in more detail below, we believe that a narrow definition of the standing charge will result in under recovery of costs from customers with low usage, resulting in significant cross-subsidies between high and low users. Such cross subsidies would clearly fail to meet the non-discriminatory requirement of both the EU Directives and the Supply Licences and Ofgem must take account of this unintended consequence of its proposed intervention.

It is worth noting that a wide definition of the standing charge would result in the inclusion of suppliers' fixed costs. Whilst it is appropriate for such costs to be considered in any assessment of fixed costs used in setting the standing charge, it is not appropriate for Ofgem to set the cost of elements that would otherwise be open to competition. In particular, it should be noted that the variation in supplier fixed costs means there is no 'right level' at which to set the standing charge.

SSE believes that this makes setting the standing charge an intractable problem for Ofgem, and underpins our belief that Ofgem should not implement this proposal.

Problems arising under narrow definition

A narrow definition poses more problems than a wide definition. As described in our February response to the main RMR consultation, a low standing charge would result in under recovery of fixed costs from customers - resulting in a cross subsidy whereby large users would make up for the losses incurred by low users. We note that Ofgem stated "the standing charge would be policy-neutral and would not be used for the purpose of promoting environmental, social or other policies"[1]. The entrenched cross-subsidy under a narrow definition would appear to contradict this principle. Whilst "low energy consumers are more likely to be low income"[2] it is not the case that the high users providing this subsidy are necessarily on high incomes – indeed this cross subsidy will have a detrimental impact on a significant proportion of vulnerable customers.

Ofgem have cited the report "Understanding 'High Use Low Income' Consumers" (Centre for Sustainable Energy, 2010) to support their assertion that some low income households would be better off if the level of the standing charge were reduced. It is of great concern to SSE that Ofgem has glossed over the core focus of that report, namely the significant proportion of low income households with above average consumption:

> Some 1.7m, 1.5m and 1.9m households in income poverty have above average energy consumption [for electricity, gas and dual fuel respectively]. This is around one third of all households defined as 'poor'[3]

CSE used the definition that a household is 'poor' if annual household income is less than 60% of median. The report is based on three years' of UK Expenditure and Food Survey (EFS) data (covering April 2004 – December 2007). This data shows that 28% of households with above average usage are in the lowest two quintiles of household income (this increases to over 30% of households when the slightly broader definition of poor households above is used).

Not only would the narrow definition of the standing charge be to the detriment of one third of poor households, but approximately one third of the households paying a premium to subsidise loss making customers with low usage would themselves be 'poor'. The narrow definition leads to a standing charge that is neither non-discriminatory nor cost-reflective and would therefore have a very negative impact on many vulnerable customers.

Figure 1 below shows the distribution of contribution to total profit across consumption deciles for SSE's mix of customers based on three different levels of standing charge; £170pa

[1] RMR: Domestic Proposals consultation document, para. 2.24
[2] The Standardised Element of Standard Tariffs under the RMR, para. 2.32
[3] CSE report "Understanding 'High Use Low Income' Consumers", p.9, para. 2

(current SSE level), £200pa (current average for big suppliers excluding SSE), and £15pa (possible level of RMR standing charge based on a narrow definition of fixed costs).

Figure 1 reveals the following points about recovery of costs and contribution to profit by each decile (key data is summarised in Table 1 below):

- Under the current SSE standing charge: the largest 20% deliver 36.2% of income and 47% of profit, whilst the smallest 20% deliver 8.7% of income and 0% of profit
- Under the average standing charge of big suppliers (excl. SSE): the largest 20% deliver 35.5% of income and 42% of profit, whilst the smallest 20% deliver 9.3% of income and 5.4% of profit
- Under RMR narrow definition: the largest 20% deliver 38.4% of income and *83% of profit*, whilst the smallest 20% deliver 7.2% of income and *a loss of 25%*

At present, suppliers are free to make a commercial decision on how best to manage the trade-off between cost-reflectivity (full cost recovery from each segment of their customer base) with the pressure to keep standing charges as low as possible (taking account of the negative impact on fuel poverty that a higher standing charge would have). Each supplier necessarily monitors the profitability of all customer segments to avoid being cherry picked by less profitable customers – the freedom to adjust the standing charge at the next tariff change gives suppliers scope to offer more competitive standing charges. By removing this freedom, Ofgem will directly affect the level of appetite that suppliers have to accept the risk of under recovery of fixed costs across their customer base, with an adverse impact on competition.

It is clear form the data in Table 1 that the current standing charges levied by SSE and the other large suppliers are far more effective in ensuring that the profit contribution from all consumers broadly reflects the demand profile across all demand levels. It is also clear from this chart that if SSE were to revise the level of the standing charge, it would be more likely to result in an increase from current levels, rather than a decrease.

The degree to which the standing charge based on a narrow definition fails to deliver a profit contribution which tracks demand is marked. Setting the charge at £15 (around the indicative level Ofgem has provided for the narrow definition) results in low usage customers returning a significant loss (equivalent to 25% of total profit), whilst high usage customers pay an equally significant premium to compensate for this loss (contributing a disproportionate 83% of total profits).

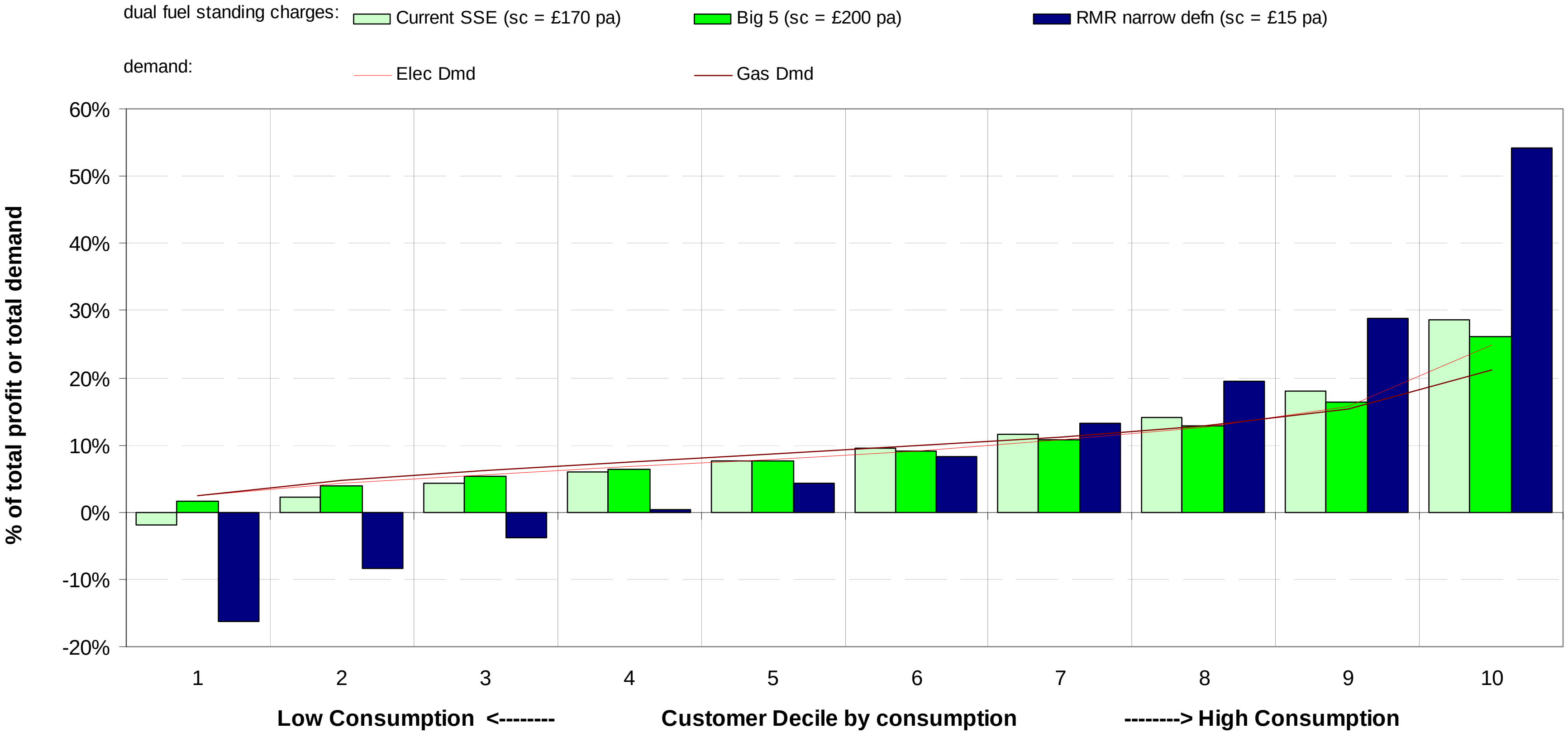
A further impact of the narrow definition is that customers are likely to pay more than they need to in winter. With the narrow definition, roughly £170pa of fixed costs will be recovered through unit rates. This effectively shifts income collection from summer into winter (75% of gas demand and 55% of electricity demand is in winter). This leads to winter bills that are about £25 higher than they need to be (to recover fixed costs) with summer bills correspondingly lower. In cold winters, with a 10% increase in demand, customers will overpay by about £17pa.

Figure 1 also summarises the potential impact of these profit profiles on the market. Suppliers are likely to seek to avoid acquiring new loss making customers, and may set ever higher unit rates for customers on standard tariffs to avoid the complete erosion of margins as increasing numbers of higher usage customers switch to fixed-term offers. Meanwhile, fixed-term tariffs will be used as a means of cherry picking higher value customers given the large savings that will be available for larger users switching to tariffs with a relatively high standing charge and a lower unit rate.This pattern would ultimately result in the entrenchment of a two tier market where customers on standard tariffs would be relatively worse off than they are in the current market.

	Largest 20%		Smallest 20%	
	Income (%)	Profit (%)	Income (%)	Profit (%)
SSE: £170pa	36.2	47.0	8.7	0.0
Average big suppliers (excl SSE): £200pa	35.5	42.0	9.3	5.4
RMR narrow definition: £15pa	38.4	83.0	7.2	-25.0

Table 1 Impact of standing charge level on contribution to profit for largest and smallest consumption quintiles

Figure 1 Expected Profit Contribution across Consumption Deciles for different tariff structures
(based on SSE mix of customers across consumption & payment method)



Suppliers less engaged with loss making customers		Suppliers target high value customers with FTCs which undercut the standard tariff through higher standing charge and lower unit rate
Core tariff price increases as large customers switch to fixed term contracts		

Problems arising under wide definition

SSE agrees with the items included in the wider definition of fixed costs. However, it is clear that fixed costs to serve vary significantly by supplier (as seen in the consolidated segmental statements) and cost to serve also varies by payment method. Similarly metering charges vary between prepayment and credit meters. These considerations mean that it is inappropriate to apply a single view of fixed costs to all suppliers.

The significant downside of the wide definition is the adverse impact on fuel poverty. Ofgem note that a wide definition will lead to higher bills for customers with low usage (RMR: Domestic Proposals consultation document, Table 1). This would be the consequence of improving cost reflectivity by moving to the standing charge costs which suppliers may currently choose to recover through the unit rate (dependent upon each suppliers appetite for the risk of under-recovery of fixed costs and on their own assessment of whether or not they are exposed to being cherry picked by loss-making customers). Any such increase of bills for low usage low income customers will have a detrimental impact on fuel poverty and therefore on suppliers' costs associated with bad debt.

Similarly, a move towards a cost reflective (higher) standing charge accompanied by a reduction in unit rates would erode the benefits of energy saving measures and increase the length of time required to recover the cost of installing such measures. Whilst this outcome is unsatisfactory, it would be the inevitable consequence of ensuring that the standing charge is as cost-reflective as reasonably possible.

SSE therefore believes that if Ofgem is to set the standing charge, it is imperative that the costs of government schemes including Energy Company Obligation (ECO) and the Warm Home Discount (WHD) are first changed from 'per customer' to 'per unit' costs. As well as simplifying the standing charge this would reinforce the message on energy efficiency by increasing the financial benefit to customers who install energy efficiency measures.

Treatment of network charges

Ofgem's proposed treatment of gas network charges as unit based costs is an over simplification. Capacity charges are not consistent with a mass market tariff structure. The charge is linked to historic consumption, but it is adjusted to seasonal normal weather conditions and to fit an average pattern of usage - as such it is fixed in the short term and variable in the long term.

We also note that whilst the tendency in policy from Ofgem's Networks team is towards more cost reflective charging (even at the possible risk of increased volatility of network charges) the current proposals from the Retail Markets team are going in the opposite direction (based on an assumption of stable and predictable cost structures, and 'a broader assessment of the appropriate level'[4]). The volatility of network costs is likely to arise as a consequence both of revenue volatility under RIIO, and through amendments to the common charging methodologies (industry codes to which any network operator can propose changes).

For both electricity and gas, SSE estimates that the weather adjusted demand of domestic customers in 2011/12 represented a year on year drop of around 4.5%[5]. This continues the recent trend in which the average demand for gas for SSE's domestic customers has fallen by over 25% since 2005[6]. Should this reduction in demand continue into the future (due to increased take-up of energy efficiency measures, say) then Ofgem's proposed approach will result in persistent and significant under recovery of network costs in warm (low demand) years and over recovery of costs in cold (high demand) years.

SSE is seriously concerned by the risk that imposing an inappropriate treatment of network charges on suppliers could result in calls to reopen discussion of charging methodologies. Network charging is an extremely polarising topic and the recently agreed common charging methodologies therefore represent the result of significant work in this area. This risk would be negligible if Ofgem instead allows suppliers to retain their current freedom to set their own

[4] The Standardised Element of Standard Tariffs under the RMR, para. 2.12
[5] http://www.sse.com/PressReleases/2012/EndOfYearHighlights/
[6] http://www.sse.com/PriceTracker/

standing charge (and the freedom to adjust it should under recovery of costs across their customer base become a problem).

If Ofgem are to pursue the proposal to set the standing charge, a means needs to be found by which gas network operators receive the same income as at present (based on the currently agreed methodologies) recovered from suppliers through network cost structures that are explicitly based on a fixed element and a unit rate element. Until the network cost structure is more compatible with tariff structures, it will be impossible for Ofgem to set a standing charge that is sufficiently cost reflective to avoid distorting the market or damaging competition. Furthermore, if any changes are made, it is important that connection signals and investment drivers are retained. Any attempt to modify suppliers' cost structures would therefore be extremely difficult to deliver.

EdF have proposed that Ofgem set up a national clearing house for domestic transmission and distribution charges. This would provide a means for network operators to recover the same quantum from suppliers as under the current arrangements whilst allowing Ofgem to determine an appropriate national standing charge to be applied to all domestic customers. SSE believes that this proposal is not workable at present; the redistribution of wealth from low cost to serve to high cost to serve areas encroaches on social policy and would, we believe, go beyond Ofgem's remit to act in the best interests of consumers. Further work would be required to establish whether a solution of this type could be feasible in the future.

Alternative proposal

SSE believes that the main benefits Ofgem hopes to deliver could be achieved by standardising the tariff structure - but not setting the level of the standing charge. We would advocate the following:

- Requiring that *all* tariffs (evergreen and FTC) are based on a standing charge and a single unit rate
- Ofgem could set the minimum level for the standing charge and allow each supplier to set the level of their own charge in response to competitive pressures

These measures would reduce complexity, increase transparency and would facilitate simpler comparison of *all* tariffs in the market, rather than restricting the benefits of simplification to the standard market only. This would also provide the greatest scope for suppliers to recover their own particular internal costs across their specific mix of customers (dependent on both consumption level and payment method).

A further benefit is that this tariff structure better reflects the underlying cost structure than a No Standing Charge (NSC) or block arrangement. Similarly, the removal of all NSC tariffs would provide more meaningful tariff simplification than Ofgem's core proposal currently offers and would more directly address consumer concerns around tariff proliferation.

Conclusion

In light of our concerns around the proposal to set the standing charge, we would urge Ofgem to reconsider its position. The unintended consequences of the proposal to set the standing charge could include significant harm to competition and will have a particularly adverse impact on the 30% of high usage households defined as 'poor' and on all households with low usage.

Whilst we have identified significant harm that could be caused by both narrow and wide definitions of elements of the standing charge, we believe that the market distortion and market segmentation that would arise as an inevitable consequence of a narrow definition would be far more serious. For this reason, we believe that standing charges should be as cost reflective as reasonably possible and ideally should be set by each supplier.

We present our responses to the specific consultation questions in the Appendix.

Appendix 1: Answers 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?*

No.

SSE does not support Ofgem setting the standing charge. However, if Ofgem *is* to set the standing charge, then it should be as cost reflective as reasonably possible to minimise market distortions and avoid the creation of a significant cross subsidy of low usage households by high usage households.

SSE believes that it is inappropriate for Ofgem to set the standing charge without first ensuring that Government scheme (ECO, WHD etc) obligations are determined on a per unit basis, rather than a per customer basis. Whilst these costs are per customer, the level of the standing charge would need to increase for most customers in order to remain completely cost reflective. This would have an adverse impact on both fuel poverty and on the clarity of energy efficiency messages (the benefit of installing energy efficiency measures is reduced in a regime of higher standing charges and lower unit rates).

Treating gas network capacity charges as purely unit based costs is at best an oversimplification. Recovering these costs entirely through the unit rate increases the weather dependence of cost recovery (meaning that customers will overpay by a significant amount in cold weather). However, against the backdrop of real and sustained falls in domestic consumption, the trend will be that suppliers systematically under recover their network costs. If some portion of this cost were recovered through the fixed element of the tariff it would allow suppliers to better manage their risk of under recovery and the consequent cash flow problems that this would cause.

Meanwhile, by moving recovery of the majority of fixed costs to the unit rate, Ofgem will minimise the standing charge, and will therefore set it at a level that is guaranteed to have an adverse impact on the profitability of customers with low consumption.

If Ofgem is minded to pursue this proposal then it is imperative that the standing charge is set to be as cost reflective as possible. In proposing to set the standing charge based on 'a broader assessment of the appropriate level' (Para 2.12), the Markets team at Ofgem are moving in the opposite direction to the Networks team. There is increasing emphasis on cost reflectivity in setting network charges (with the likely increase in volatility of network charges that this will engender, both as a consequence of RIIO and also due to the potential for parties to instigate changes to the charging methodologies). It is important that the RMR does not introduce measures that make it more difficult for suppliers to run their business effectively. Removing the suppliers' freedom to set the standing charge at the appropriate rate is particularly perverse as changes in the network charging methodologies take effect.

<u>European jurisprudence</u>

The European Commission has outlined principles behind reasoned opinions issued regarding end user pricing, including the following:-

- End-user prices set by state intervention present obstacles to new market entrants and therefore deprive consumers and companies of their right to choose the best service on the market.
- All companies must have the possibility to freely provide services all over the EU and set their own prices which reflect the real situation on the markets.
- Regulated prices distort the functioning of the market, defining prices which do not reflect the real needs of the market and prevent free competition and market integration
- [Regulated end-user prices] …lead to either underinvestment or unnecessary high prices.

The European Court of Justice in its 'Federutility' judgement (Case C-265/08) clarified the criteria under which regulated prices could be compatible with Internal Energy Market legislation; these included the condition that end user prices be "clearly defined, transparent, *non-discriminatory* and verifiable." SSE believes that the non-discriminatory condition will make it impossible for Ofgem to arrive at a single standing charge that is appropriate for the entire market.

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)?*

Ofgem have included the correct range of elements in the broad assessment.

We would highlight that certain of these elements (metering and suppliers' other fixed costs) are subject to competition – costs vary significantly between different suppliers. As such, it is not appropriate to set an average level of these costs (one size does not fit all). Omitting these elements in favour of a narrow assessment results in a charge which is not cost reflective (and would result in suppliers over recovering costs in periods of high usage).

Both the broad and narrow assessments of the standing charge would therefore breach the guidelines described above for the regulation of end-user prices, either by setting prices which do not reflect the real situation on the markets (broad) or by introducing discriminatory prices (narrow).

SSE is seriously concerned that the treatment outlined in Appendix 1 would result in an averaged value for the annual DUoS fixed cost. This would disadvantage suppliers with large numbers of customers in more expensive distribution areas (such as the north of Scotland). This is yet another departure from cost reflective pricing.

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

Neither option provides for cost reflective pricing. We believe that both the standing charge and the unit rate need to be regional in order to correctly reflect fixed cost structures.

The standing charge needs to be set on a regional basis. The use of a regional unit rate adjuster would result in complicated bills that would increase customer confusion and would completely undermine the principal underlying the RMR, whereby the provision of better and clearer information to customers will result in greater consumer trust in energy suppliers.

Proposal	**Issue**
Option 1: Ofgem sets a national standing charge and regional adjuster to the unit rate. Suppliers set a unit rate.	Simple comparison of national unit rates achieved at the cost of greatly increasing complexity of customer bills (three tariff elements rather than two). This outcome makes this proposal incompatible with the package of RMR proposals which seek to build trust of energy companies based on simpler and clearer communication with customers.
Option 2: Ofgem sets a national standing charge. Suppliers are able to set different unit rates in different regions to reflect cost differences.	Publication of unit rates on a national basis would be of little benefit: the number of regional unit rates would make any national table of charges overwhelming. It is extremely unlikely that any currently disengaged customers would respond to a 'nudge' that was no clearer than existing information.

It is difficult to see how Ofgem can arrive at a genuinely simpler presentation of costs whilst maintaining reasonable cost reflectivity in the absence of a revised means of recovering network costs from suppliers. The recently agreed network charging methodologies identify the correct quantum to be recovered from suppliers – the issue is that the cost structure imposed on suppliers is not consistent with domestic tariff structures. Resolving this inconsistency would be a prerequisite for the type of tariff simplification which Ofgem seeks. To attempt to impose a simplification of the recovery of network costs through regulating the standing charge is to treat the symptom, rather than the root cause. SSE believes that network charges are inevitably more complicated than domestic tariff structures since they arise from a cost reflective assessment of network costs which is necessarily asset based (to provide the correct connection signals and investment drivers necessary for efficient networks).

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

The approach Ofgem describe in Appendix 2 is a pragmatic treatment, dealing with the conversion of tariffs presented as p/pdkWh to p/kWh. We disagree with Ofgem on two fundamental points.

Firstly, whilst suppliers can make simplifying approximations in order to convert network tariffs to fixed and unit rate based elements, it is on the basis that any significant discrepancy between charges and recovered costs can be addressed through re-tariffing. Whilst setting the standing charge is under suppliers' control, the decision about the best means to pass an approximated network cost to customers is a commercial one. SSE believes that Ofgem would be in dangerous territory in proposing to make such a commercial decision on behalf of all suppliers. If Ofgem are to set the standing charge it would introduce significant delays into the process, which would be particularly problematic in the event of a mid-year change to network charges (the risk and impact of which, we believe, is under estimated in this consultation).

The second point on which we disagree with Ofgem is whether these costs can be treated as *purely* unit based charges. These charges are linked to historic consumption but are adjusted to seasonal normal weather conditions and to fit an average pattern of usage. The charges are therefore fixed in the short term but variable in the long term. A more appropriate treatment would recover a portion of these charges through a fixed element per customer (reducing the risk of significant over or under recovery of fixed costs due to weather related effects).

It is interesting to note that whilst Ofgem's Networks team is placing increased emphasis on cost reflectivity (with possibly increased volatility of network costs arising both through RIIO and the fact that the charging methodologies are industry codes, modifiable by all), the approach proposed by the Retail Markets team suggests great faith in the reliability and consistency of consumption levels and steady trends in network charges. SSE believes that one of the consequences of Ofgem's proposals, given the timetabling issues discussed below, will be an increased exposure of suppliers to cost variances.

The proposed identification of regions and allocation of charges to the appropriate ex-PES region reflects current practice. However, this results in charges that are not completely cost reflective (as Ofgem have noted in Appendix 2) and, as discussed above, SSE believes this poses problems for Ofgem.

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?*

The broad assessment requires a departure from cost reflectivity, our concerns at which are discussed above.

Increased volatility of network charges will make the formulaic approach extremely unreliable. It is not useful to provide "certainty… regarding the future level of the standing charge" (The Standardised Element of Standard Tariffs under the RMR, para. 2.28) if it is not possible to provide certainty over the level of the fixed costs that the charge should recover.

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

Setting the standing charge will imply a timetable of tariff changes. Since suppliers will still have to react to changes in market prices over the year – and the time at which this change becomes necessary is unlikely to coincide with the date on which the standing charge is set – the core proposal is likely to increase the number of tariff changes over the year. The uncertainty and confusion this could cause customers is of particular concern; consumer groups have reported to us that the fear of future increases is almost as concerning to vulnerable customers as the actual increases themselves.

By reducing the likelihood that suppliers will be able to consolidate changes in network costs and market prices into a single price change, Ofgem will be directly responsible for the increased regularity of pro-rated bills, which make it harder for customers to keep track of what they are paying and increase confusion.

In order to aid customer understanding of tariff changes, SSE does not change prices twice within any six month period – this avoids any customer receiving a bill (credit customers) or statement (issued every six months to MDD customers) that pro-rates more than one price change. We believe this provides a clear benefit to customers. If Ofgem introduces a regime whereby there is a standing charge related tariff change on June 1st, then our only possibility of a price change to account for significant movement in commodity prices would be the start of December. To avoid this constraint on our ability to appropriately manage our market risk (or to pass savings on to customers when commodity prices fall) we would need to either change our policy on bill clarity or increase the frequency at which we issue statements to MDD customers to quarterly (with a cost implication for customers).

The suggestion that the standing charge tariff change could occur on June 1st would introduce a two month window between new charges taking effect and suppliers being able to recover increased costs. This price risk would impact all suppliers but could be particularly disadvantageous to smaller suppliers less able to absorb any increased costs. A further complicating factor is the notice period required under SLC 23 which all suppliers must meet in the event of a unilateral variation.

A further significant concern relates to the possibility of mid-year changes to network charges. This is underplayed in the consultation document. Given that the charging methodologies are industry codes, they can be modified by all. IDNOs have previously instigated changes to the methodology which resulted in significant mid-year changes in network charges. Whilst Ofgem states that they would propose changes to the standing charge in the event of significant mid-year changes to network costs, the delay in implementing this could have severe repercussions for suppliers and poses a further risk to competition in energy supply.