



Which?, 2 Marylebone Road, London, NW1 4DF

Date: 5th April 2012 To: - Chris Smith Response by: - Fiona Cochrane

Consultation Response

Chris Smith
Retail Markets Team
Ofgem
9 Millbank
London
SW1P 3GE

The Standardised Element of Standard Tariffs under the Retail Market Review

Summary

- 1 Which? welcomes steps taken to address the complexity of tariffs. Our investigation into the structure of tariffs demonstrated that many consumers struggle, if not fail, to successfully navigate tariffs structures¹. The unacceptable nature of this is further exacerbated given the homogenous nature of gas and electricity, and the necessity to purchase it.
- 2 As set out in our recent response to the *Retail Market Review: Domestic Proposals* we consider that:
 - Ofgem should extend the competitive benefits of a simplified tariff format to all single-rate tariffs, covering approximately 85% of the domestic market.
 - Mandating a simple format only for standard tariffs risks ‘institutionalising’ what is effectively already a two-tier market.²
 - Arguments of the importance of ‘behavioural incentives’ are not persuasive. These ultimately have little value if they obfuscate prices and lead to ineffective switching decisions.
 - The ‘solution’ - a price comparison guide - may be ineffective given its reliance on consumers’ knowledge of their consumption.³
 - Simplification is important but it will not in itself drive engagement, and no assumptions to this end should be made by the regulator.
- 3 Accordingly, our response to this consultation on the methodology for setting the standardised element (standing charge) of standard tariffs should not be seen as an

¹ ‘It’s time for simple energy deals’, Which? October 2011, pgs 16 - 19

² Where companies continue targeting their most competitive deals at a minority of sophisticated consumers and face few downsides to making their standard tariff the worst deal they offer.

³ The “Standard Equivalent Rate” (SER) calculates an ‘effective unit rate’ to compare differently structured tariffs. However, for comparisons involving non-standard tariffs, consumers will have to decide whether they are a low, medium or high user. Since people generally have low awareness of their energy consumption, they cannot be expected to decide which category they fit into. This is likely to increase search costs and entrench poor switching decisions.

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2 Marylebone Road, London, NW1 4DF
t 020 7770 7000 f 0207 7770 7600
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endorsement of the current RMR tariff proposals. Instead, we are commenting on the methodology in itself.

- 4 In summary:
- We do not support the proposal that the cost of social and environmental obligations should be recovered in standing charge. We consider it regressive to recover these policies in this way and it is at odds that these policies are designed to be output, rather than input, measured.
 - We consider the proposal to set some elements of the standing charge based on a broad assessment of metering and other fixed costs incurred by suppliers to be problematic. These costs are contestable and should be subject to competitive pressure; setting an allowed level for these will undermine this.
 - Based on Ofgem's assessment that T&D charges relate to consumption, regional variations should be reflected in the unit rate.

Responses 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?

- 5 No. We welcome Ofgem's determination that "it is appropriate for the majority of T&D charges to be recovered through the unit rate" given that: (i) this better reflects the way that these costs are incurred by suppliers; and (ii) it will ensure that low users, who are more likely to be low income, only pay their fair share of these costs. However, this more progressive approach to the recovery of T&D charges is undermined by Ofgem's proposal that the costs of social and environmental policies (WHD and ECO) should be recovered through the standing charge. We discuss this further in our response to Question 2.

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)?

Social and Environmental Policies

- 6 Which? considers that the most appropriate way to recover the costs of social policy interventions is through the tax system, as this would allow contributions to be related directly to income.
- 7 We recognise there are a number of policies, including social policies, which are paid for through energy bills. Which? considers that these should be paid for as a proportion of the unit rate, not a fixed amount in the unit charge. The majority of low income households use significantly less energy than high income households⁴ and the poorest 10 per cent of households produce only 45 per cent of the CO₂ levels produced by the

⁴ 'Continuing to use the 30% of households to with the lowest incomes as a proxy for the fuel poor, richer households have increased their expenditure on gas and electricity, between 1999/2000 and 2007/08, by one third more than the poorer households. During 1999/2000, richer households spent 41% more than poorer households on gas and 31% more on electricity. Eight years later, the gap has had grown to 57% and 42%, respectively.' - Section: Energy consumption by the fuel poor, over time - pp109-111) Brenda Boardman, Fixing Fuel Poverty, Earthscan, 2010.

most affluent 10 per cent of households⁵. As such, including the policies as part of the unit will limit the regressive nature of paying for policies through bills⁶.

- 8 While the ECO is also designed to serve social purposes, its objectives, as we understand them, are largely environmental. It therefore seems perverse to propose that the costs of this policy are recovered as a fixed amount through the standing charge, as this would poorly reflect the difference between the social and private costs of energy use (ie be consistent with the ‘polluter pays’ principle).
- 9 More fundamentally, introducing the idea of a nominal ‘target spend’ for supplier obligations that are measured by output (eg carbon saved/ affordable warmth delivered), rather than input, may distort supplier incentives and therefore undermine the efficiency benefits to consumers of delivering these policies and services through competition. The effective allocation of a fixed non-contestable cost to a contestable cost driver, may also distort consumer behaviour by segmenting or justifying (and therefore legitimising) in the minds of consumers that some costs - or, at least, the level of some costs - are simply inevitable.

Fixed Costs

- 10 In contrast the fixed costs set out in Ofgem’s proposals (metering and billing) may not be determined by consumption. These are *technically* contestable costs, which do vary between suppliers, may vary according to the type of account the customer has and which Ofgem have to date viewed as being subject to competitive pressures.
- 11 Consequently we are concerned that by including these ‘fixed costs’ in the standing charge, the standing charge levels, as determined by Ofgem, will weaken any pressure on these elements. The proposals fail to demonstrate a methodology that will ensure there is pressure on suppliers to improve the quality and efficiency of these elements. There is also no clarity where the line falls between this approach and price controls.

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

- 12 We support Option 2- Ofgem sets a national standing charge; suppliers set a unit rate in each region. This reflects Ofgem’s analysis that the network charges correlate with consumption and that network charges are the primary factor for regional variation.

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

- 13 No.

⁵ Roberts, S. (2008) *Energy, equity and the future of the fuel poor*. Energy Policy 36, pp 4471-4474

⁶ There are a proportion of low income households that do consume above average levels of energy - ‘the high use, low income consumers’, although the exact number is not clear. These tend to be single fuel- electric based heating- households and in hard to treat, inefficient homes. (Brenda Boardman, *Fixing Fuel Poverty*, Earthscan, 2010; Centre for Sustainable Energy, *Understanding ‘High Use Low Income’ energy consumers*, 2010; Joseph Roundtree Foundation, *Time to reconsider UK energy and fuel poverty policies?*, 2011). While supporting proportionate recovering of policy costs, it is recognised that there is a need to protect these high use, low income consumers. In their 2011 report, the Joseph Roundtree Foundation propose ‘The introduction of a proportional levy with some in-built protection for low-income high-users. Such a mechanism could assist in reducing profligate energy consumption amongst high energy-users who are able to reduce their discretionary energy use without compromising their health and well-being, whilst protecting low-income households who, due to their circumstances, are required to consume high amounts of energy (e.g. hard-to-treat inefficient homes).’



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?

14 As set out in Paragraph 11, we have concerns with the current methodology. At a minimum, Ofgem should be considering basing costs on those that would be incurred by an efficient supplier, rather than the 'average' supplier implied in the proposal.

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

15 Yes.

Which?
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