Sustainability *first*

Maxine.frerk@sustainabilityfirst.org.uk

17 January 2024

To: StandingCharges@ofgem.gov.uk

Dear Ofgem

Standing Charges - Call for Input

Sustainability First is a charity and think-tank with a focus on social and environmental issues in the energy and water sectors. Through our work we have given significant thought to issues of fairness in charging (see, for example, our "What is Fair?" report) and have contributed to a number of past consultations on this topic. We draw on this thinking to contribute to what we see as an important issue in the context of the current cost of living crisis (which has driven massive increases in debt levels and extreme energy rationing) and the huge increase in the standing charge which on electricity has more than doubled in the last two years.

In summary, our position is that volumetric charging is fairer but targeted support would be needed for the minority of households who would lose out, with better data being needed to properly understand the issue. Ofgem has a clear responsibility to address this although government has a key role too. A move away from standing charges would support wider Ofgem goals around flexibility. This is not just about the price cap but about the underlying cost structure and network charging – including looking at more radical solutions for recovery of residual / policy costs. In the interim, finding a solution for prepayment meter customers should be a priority.

We expand on each of these points below.

- **Volumetric charging is fairer**: Sustainability First has long- taken a considered view that a volumetric charge is less regressive (and as such fairer) than a fixed charge as set out in the report on the TCR produced by Grid Edge Policy for Sustainability First. Indeed, with the current cost of living crisis following on from Covid, we would expect that budget pressures will have further reinforced that pattern – and recent reports by Frontier Economics confirm that trend. While not perfect, a move to more volumetric charging would also give consumers greater control over their energy costs, recognising budgeting control is a key factor in affordability and in supporting positive mental health. Standing charges raise particular issues for prepayment customers who have to clear any build-up of standing charge debt before they can start using energy again after self-disconnecting.

- **Targeted support is needed for the minority of vulnerable households who would lose out**: We recognise that although most low-income households use less energy than average, and hence would pay less under a volumetric approach, there are some exceptions, who would face higher bills as a result. In terms of a vision for the future of retail markets, the aim should be for targeted mitigation to help those with particular needs, rather than designing the tariff structure around this small minority. Action to address the over-charging in the price cap of customers on

Economy 7 (which Sustainability First has highlighted previously), would help one key group that would be disadvantaged by a move to more volumetric charges.

- **Better data is needed to understand the issue**: We have argued before for further work to understand who the losers would be from such a move and to identify any additional mitigating actions needed. This latest Call for Input appears to have more granular data on consumption patterns of eg disabled, low-income households but also says that it is based on the CSE archetype analysis (which does not include that detail). More transparency is needed around the sources of data that Ofgem has used for its analysis. One of the problems to date has been a paucity of data linking energy usage and demographics as discussed in our work on access to smart meter data for a public purpose (PIAG). While we welcomed the development of the CSE archetypes we have raised some technical concerns previously[1] which we encourage Ofgem to revisit as a part of this exercise.

  In particular, the CSE analysis uses the Living Costs and Food Survey which paints a somewhat different picture from DESNZ's NEED database (which Ofgem does not use for its distributional analysis although it uses it for eg TDCV). We would expect Ofgem to be looking across these different data sources (including the new UCL SERL database of a sample of 10000 customers) to build up a fuller picture and to understand any differences in what they show. There is also a need to build a better understanding of how much energy is needed in practice for different customer segments in different housing types and parts of the country to be healthy and well and participate in modern society.

- **Ofgem has a responsibility to address this:** It feels somewhat disingenuous for Ofgem to argue that they do not set a standing charge and that they expect suppliers to provide tariffs that consumers want. The current level of the standing charge reflects past Ofgem decisions on network charging and the structure of the retail price cap. The regional differences reflect their network price control decisions. Of course suppliers could in theory price below the cap to reduce standing charges, but this is unlikely to be commercially viable on any scale. While Utilita has agreed an alternative structure with Ofgem - a two part tariff that means prepayment customers do not pay a standing charge if not using any energy - this leaves Utilita bearing that shortfall. And while the Utilita tariff helps those on prepayment who may be self-disconnecting, the boundary between the two tiers is set at a level that means that it is equivalent to a standing charge in terms of the distributional impacts.

- **Government has a key role too:** In particular the allocation of certain policy costs is set by government and government are best placed to develop protection for low income, high usage households. They should also take the lead in understanding the impact of changes to the Warm Home Discount and the implications for high usage disabled groups that are losing out. Increased data sharing to aid targeting of support is also an issue for government.

- **A move away from standing charges would support wider Ofgem goals around flexibility:** On the underlying structure of network charges and the significant rebalancing that has taken place

[1] https://www.sustainabilityfirst.org.uk/images/publications/consultations/Distributional_Impacts_Grid_Edge_Policy_300920.pdf

through the TCR and other reviews, we have consistently argued that viewing network costs as essentially fixed costs is misguided. The move to socialisation of distribution connection costs will further increase the level of residual charges going forward. At a time when we are talking about needing to double the size of the grid and of the importance of demand side flexibility it seems very wrong to be moving away from a charging structure that would encourage this. The Call for Input argues that a high proportion of network costs are fixed - a forward-looking view of network costs would surely lead to a different conclusion.

- **This is not just about the price cap but about the underlying cost structure**: We recognise that to simply change the balance in the price cap between standing charges and unit rates would have impacts on suppliers, and hence for their customers. In particular, if standing charges were reduced and unit rates increased without changing the underlying cost structures, then low usage customers become unprofitable and high usage customers more profitable, and increases in usage would increase supplier profits. This in turn may make low income, vulnerable customers less attractive to suppliers, reducing the level of service they receive; as well as disincentivising suppliers from supporting energy efficiency. These unintended consequences can be avoided by changing the underlying costs that suppliers face in parallel with changing the retail cap. In particular, removing standing charge elements from all network charges (rebalancing to unit rates) and allocating SOLR and other policy costs to unit rates would allow equivalent reductions in standing charges in end-customer tariffs via the retail price cap, without the adverse consequences noted above.

- **Prepayment customers should be a priority**: For the reasons set out above prepayment customers are particularly impacted by high standing charges. Moreover, very few PPM customers are low income, high users – and those with significant health issues, for example, should not be on prepay. Even without rebalancing the price cap there are things that could be done for this group either following the Utilita model or, as suggested by National Energy Action, requiring suppliers to add standing charge debt to any overall debt (where ability to pay has to be taken into account in setting repayment levels) rather than as now where it has to all be paid off before the customer can use any energy again after they have self-disconnected.

Public perceptions of fairness are ultimately critical even for an independent regulator –a number of politicians and campaign groups have argued against the standing charge, in part as it is deemed 'unfair' as you don't have a 'choice' in whether you pay it regardless of usage and it takes away 'control'. As noted above, this sense of injustice is particularly felt by many prepayment meter customers. Sustainability First has previously proposed a number of **more radical but potentially fairer long-term solutions** to the recovery of residual costs and would argue that the time is right to consider such ideas, alongside current discussions around social tariffs. These include:

- the use of (peak related) **capacity charges** ie basing more of the charges on KW of capacity provided rather than KWh of usage. This would better reflect the underlying cost structure of the industry going forward – as the investment needed is linked to peak capacity. It would also offer a form of rough justice in terms of lower income households typically placing less demands on the system.
- some level of **essential usage allowance** which would be charged at a lower price or even free to those in financial difficulty (or more radically to all consumers with costs recovered through taxation as part of a minimum basic income style approach). The former could be achieved by allocating SOLR costs and residual charges / policy costs on the basis of usage

above a defined minimum level as advocated by Professor Dieter Helm in his Cost of Energy review (para 38).

- a **standing charge for export** as a more targeted way of addressing the distortion that drove Ofgem's proposals around TCR (ie that those with their own generation who tend to be better off, have low consumption and hence avoid paying their fair share of the fixed costs of the system if these are recovered through volumetric charges) – and reflecting the additional costs involved in managing bi-directional flows.

While we recognise that such options are more complex to introduce, that should not be a reason for dismissing them as longer-term solutions.

We have attached brief answers to the various questions Ofgem raises which we have expanded on in this cover letter (and in the related reports that we refer to). We would be happy to be involved in any further engagement Ofgem wishes to undertake on this topic.

Yours faithfully,

Maxine Frerk, Associate Sustainability First

Cc Zoe McLeod, David Murray

Appendix 1 – Summary of Call for Input questions

3. Standing charges, network charges and the price cap

Q1: What are the barriers to suppliers using the existing flexibility under the price cap?

They would lose money

Q2: Why are suppliers not innovating on standing charges for tariffs not covered by the price cap?

In a competitive market, tariffs will generally reflect the underlying cost structure.

Q3: What changes could Ofgem make to improve provision for lower standing charges under the cap.?

The real issue is addressing the underlying cost structure (ie previous decisions by Ofgem on network charging or SOLR costs). Moving certain policy costs to taxation would be less regressive but is a decision for government.

Q4: As a result of TCR and changes to the recovery of residual costs, domestic consumers with very low consumption now bear a share of fixed network costs which is more in line with the cost of maintaining access to gas and electricity networks. Is this fair? Should more be done to shield these customers from these costs?

We fundamentally disagree that the decisions on TCR etc mean domestic consumers with very low consumption now bear a share of fixed network costs which is more in line with the cost of maintaining access to gas and electricity costs. The essence of "residual costs" is that there is no economically correct way of allocating them and there are equally valid arguments for allocating them eg on the basis of ability to pay. We also question whether viewing network costs as essentially fixed is still right in the context of the energy transition and the huge network investment required in the coming decade. Fairness – in terms of the impacts on low-income households – should be a key consideration.

Arguments around the treatment of residual costs (including an international view) are set out more fully in the Grid Edge Policy paper for Oxford University on the Future of Network Charging, written by Associate Maxine Frerk.

Q5: What are the reasons for regional variations in electricity standing charges?

These reflect underlying differences in network costs between geographies. Some time back Ofgem looked at regional differences in network charges overall and concluded there was no case for action. However the standing charge angle does raise some new issues and it is clear that customers do perceive these differences as unfair.

Q6: Can we learn from other sectors about how to improve suppliers' tariff offering in the UK energy market?

5. Standing charges and the domestic retail market

Q7: Why do so few suppliers offer multi-tier or zero standing charge tariffs to their customers?

Customers will generally only move to a different tariff structure if it is cheaper for them which means the supplier loses money.

Q8: Why are zero standing charge tariffs no longer offered in the market, with the exceptions cited in this paper?

Because suppliers would lose money

Q9: What measures could Ofgem take to improve the range of tariffs available to domestic retail customers?

Q10: Why do no suppliers offer rising block tariff products at present? Would these products offer benefits to consumers?

A 2009 Ofgem report summarises the argument well and assumes any RBT would have to be mandated:

"It is unlikely the market would voluntarily introduce or compete on RBTs given the current structure of costs. From a supplier's point of view, the tariff would appeal to low users and appeal less to high users. If a supplier did not attract enough high using households to sign up to the tariff it would find it difficult to recover costs of supplying energy under this tariff." (Ofgem - Can Energy Charges encourage Energy Efficiency – a Discussion Paper)

Q11: How significant an impact do standing charges have on customers' incentives to use energy efficiently? What evidence can you provide that this is the case?

Standing charges per se have no impact but higher unit prices will encourage reduced usage. Previous work by Ideal Economics[2] explores the level of price elasticity and makes the case for reducing standing charges on that basis.

Q12: Are there any forms of intervention in standing charges that Ofgem might consider that would minimise the risk of producing negative outcomes for some customers?

There will always be winners and losers – the question is where can action be most readily taken to support any customers with particular vulnerabilities who are materially losing out.

Q13: How can we identify the complex needs of vulnerable customers and ensure that they are able to receive tariffs that benefit them the most?

Better data is key – supported by engagement with frontline consumer groups.

6. Standing charges in the non-domestic retail market

[2] https://www.ofgem.gov.uk/sites/default/files/docs/2018/09/ideal_economics_response_0.pdf

Q14: What issues affecting standing charges in the non-domestic retail sector should we consider further?