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Dear Mr Lawrence,

## **RECCo response to Ofgem's Open letter: Review of how the costs of supplier failure are recovered**

We welcome the opportunity to respond to the above open letter. This response represents the views of the Retail Energy Code Company (RECCo).

### **About RECCo**

RECCo was formed as the corporate vehicle for ensuring the proper, effective, and efficient implementation and ongoing management of Retail Energy Code (REC) and to promote innovation, competition, and positive customer outcomes. RECCo was developed with a clear consumer focus, and this is one of our core values. Additionally, the development of the REC was intended to directly address the adverse effects on competition arising from the industry code arrangements, as identified by Ofgem and the Competition Markets Authority. We therefore have a particular interest in this consultation and RECCo is providing this response in line with its mission statement and strategic aims.

### **Summary**

RECCo welcome Ofgem's consideration of the recovery of the Supplier of Last Resort (SoLR) levy through standing charges, though we consider that this is also an opportune time to consider the Standing Charge more broadly.

While a standing charge may be an appropriate means of ensuring all consumers contribute to the fixed costs of providing energy, their application should not by default result in ever increasing costs for consumers regardless of their usage and/or circumstances. In the face of a cost-of-living crisis with rising energy costs, this may be an aspect that could make a difference to the lives of many.

Whilst the introduction of a regulated social tariff may be a better approach to assisting those on low incomes or in fuel poverty, a removal or reduction in the costs to be recovered through the standing charge may enable households to better manage their energy costs. The provision of social tariffs was previously within the discretion of individual suppliers, but

an unintended consequence of the Retail Market Review<sup>1</sup> which required suppliers to reduce the number of tariffs they offered, was in many cases the removal of such social tariffs and other less profitable offerings.

Whilst we recognise that Ofgem considered the distributional effects of the standing charge as part of its development of the default tariff cap<sup>2</sup> we would urge it to reconsider the composition and recovery of standing charges, and whether there are now better alternatives to the currently flat rate of recovery. For instance, we consider that a more nuanced approach could allocate charge weighted according to consumer needs or property characteristics, combining data sets from mechanisms such as the Warm Home Discount, or council tax banding. This may allow a fairer basis for recovering energy infrastructure costs.

We discuss these possible solutions in the response below. As requested, we have attempted to provide a brief response to the consultation questions but would be happy to further discuss any of the points raised.

## RECCo response

### a) Do you agree with the rationale for our review into SoLR cost recovery?

Reviewing the composition and recovery of SoLR costs is important, and we understand the rationale set out by Ofgem. Nevertheless, RECCo believe that a broader approach to the review of the standing charge should be undertaken. Although retailers have the option to set these charges to nil, and rebalance the recovery through higher unit charges, our understanding is that no distinction is currently being made between types of consumers or usage, resulting in a generally fixed or flat charge approach.

Whilst the consultation focuses on the effect recent SoLR events are having on the charge, there are several other factors that would warrant a broader review, not least, that the fixed charge is applied to all consumers. This has a regressive effect for low consumption consumers. Therefore, any benefit of implementing only the narrow change currently being consulted upon will be limited.

Ofgem has not detailed why the scope of the review is limited to only the SoLR aspects of the charge. Whilst we recognise that this element has been brought into focus by recent market failures, it compounds rather than creates the current affordability crisis facing energy consumers. We consider that Ofgem has both the opportunity and the necessary powers to make a greater contribution to tackling this crisis through a more socially aware approach to energy pricing policy.

- b) How do you consider we should manage trade-offs between charging on a fixed charge basis vs. volumetric?**
- c) Should SoLR costs be recovered by fixed charges, unit rate charges (i.e. volumetric), or some other method?**

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<sup>1</sup> See: [The Retail Market Review – Implementation of Simpler Tariff Choices and Clearer Information](#)

<sup>2</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/decision\\_-\\_default\\_tariff\\_cap\\_-\\_overview\\_document\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2018/11/decision_-_default_tariff_cap_-_overview_document_0.pdf)

We note Ofgem's consideration of the impact of a volumetric approach on consumers with high usage. We think the response to questions b) and c) are closely linked and therefore combined our response.

As Ofgem highlights, those with on the lowest incomes are often housed in properties that are the least energy-inefficient while conversely, low-usage properties may be indicative of investment in better-quality energy-efficient housing. Consumption alone is therefore not a wholly reliable indicator of ability to pay and could lead to unintentionally regressive charging regime for many who are already struggling to pay for their energy needs. We recognise the conundrum faced by Ofgem in trying to balance its various duties in this regard.

Whilst we also recognise that the competitive market benefits from simple and charging, we do not think that all consumers are necessarily best served by a simple approach. For instance, a volumetric approach could be combined with wider socio-economic factors to produce more targeted approach to cost-recovery and better inform some of the trade-offs that Ofgem have highlighted. For instance, the Warm Homes Discount is an industry wide mechanism which is well known by consumers and could be referenced as a basis for a reduction/reduced volumetric or fixed charges. There may also be lessons from the Warm Homes Discount reconciliation process, which acts as a levelisation mechanism ensuring that those suppliers with higher-than-average qualifying consumers are not unfairly disadvantaged. This approach could similarly be applied to the full standing charge and therefore make a more significant impact on the cost-of-living crisis, saving a qualifying dual-fuel consumer around £200 a year. Importantly, this would also be an enduring saving rather than a one-off or time-limited rebate. However, we also recognise that in the absence of this support being funded through general taxation, these costs would need to be re-distributed to other energy consumers, which would justify it being strictly targeted and limited intervention.

We also acknowledge that differentiated standing charges may be a significant change to billing. In the short-term, this could be accommodated through a rebate scheme rather than through primary billing. Such rebates could be offered to qualifying consumers as part of a package of financial support.

Combining several factors and consumer characteristics will become increasingly practicable with adherence to open data principles and could result in an approach that not only better targets those in need, but also better manages trade-offs. Applying this to the whole standing charge may yield greater consumer benefits than those of more limited change currently proposed.

**d) Do you consider that vulnerable consumers' interests are best served through the use of fixed charges, unit rate (volumetric) charges, or some other method? Please share evidence where possible.**

As recognised by Ofgem, consumers may be vulnerable for a number of reasons, a more nuanced approach should therefore be taken to protecting different vulnerabilities. RECCo (amongst others) are currently looking at how to improve the efficacy of the Priority Services Register, enabling better data sharing across suppliers, DNOs and potentially other users. A more effective segmentation of consumers and their energy needs rather than one based simply on current levels of consumptions would allow for fairer charging and could be achieved with existing data. Whilst the initial focus could be on a better targeted and fairer

allocation of fixed costs to be recovered through standing charges, such an approach could extend towards more holistic social tariffs. Unit rates could also be differentiated in order to better reflect consumer needs and ability to pay, whilst preserving incentives upon those consumers to use energy efficiently.

- e) If changes were deemed to be necessary, should that take place:**
  - i. On an enduring basis; or**
  - ii. On a time-limited basis?**
  - iii. And if so, why?**
- f) If changes were deemed to be necessary, would you rather that they:**
  - i. were implemented using standard industry processes, even if this takes longer; or**
  - ii. were implemented as soon as possible, even if this meant using nonstandard processes?**
  - iii. And if so, why?**

We consider that it may be appropriate to pursue the limited change to the standing charge arrangements set out in this consultation, on a time limited basis and expedited through a non-standard process. This would mitigate against the already regressive effect of standing charges being further compounded by the policy of socialising the cost of supplier failures through network charges. However, whilst it is understandable that Ofgem is itself seeking to make rapid policy changes in advance of each impending tariff cap period, market participants would welcome greater certainty. A more thorough and holistic review of the standing charge may be appropriate, particularly given the current absence of a social tariff for energy.

**g) Do you consider there to be any interactions between the method of SoLR cost recovery and the support provided from the recently expanded government Energy Bills Support Scheme?**

The government's Energy Bill Support Scheme was designed as a one-off short-term measure. The review of the Standing Charge should be seen as a longer-term enduring change and thus should not be seen as being mutually exclusive or in any way dependent upon the Energy Bills Support Scheme.

Ultimately, Ofgem should seek to ensure that the costs of a supplier failure are borne primarily by the investors in that commercial enterprise, who could then be reasonably expected to take actions mitigating that risk. Whilst some of those mitigating measures may also come at a cost, under normal circumstances those costs would be appropriately reflected in each supplier's tariff. We are concerned that while the tariff cap and other policies adopted as a consequence of the tariff cap continue to have a distortive effect on the market, risk will continue to be borne by consumers rather than investors. Unless these risks are rebalanced, which we acknowledge is already underway through Ofgem's work on strengthening retail financial resilience, the SoLR arrangements and the socialised recovery of costs may continue to have the unintended effect of subsidising unsustainable retail enterprises.

**We have no comments on questions h) or i).**

We welcome the opportunity to participate in the proposed workshop to discuss this proposal further.

Yours sincerely

**Suchitra Hammond**

**Senior Strategy Manager, RECCo**