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CREATING CLARITY

Alert - Ofgem consults on introducing zero standing charge tariff options

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| Headline assessment | |
| Document: | Consultation |
| Consultation dates: | 20/02/25 – 20/03/25 |
| Impact classification: | High: Domestic Suppliers; Consumers |
| Action if desired: | Respond to the consultation |

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1 Assessment and recommendation

On 20 February, Ofgem published a consultation seeking views on the [options to introduce a zero standing charge tariff](#) under the Default Tariff Cap. The three options include:

- **Single unit rate:** This structure includes one unit rate price, regardless of consumption.
- **Falling block tariff:** This would include multiple blocks of defined consumption thresholds, where the unit rate for the first block of consumption (from zero kWh to the first threshold) is a higher unit rate than that of the remaining consumption blocks.
- **Rising block tariff:** An opposite approach to the falling block tariff, this would mean the first block of consumption is the lowest unit rate price of the remaining consumption blocks.

The consultation outlines Ofgem's hypothetical modelling based on assumptions for how these options may impact costs for consumers, as well as outlining the risks and uncertainties that may come for suppliers in recovering portions of their fixed costs, which is normally achieved through the standing charge.

We recommend that domestic suppliers and any other interested stakeholders respond to this consultation, and ensure any additional risks or benefits are highlighted to the regulator before it moves forward with a decision. The consultation closes on 20 March 2025.

Cornwall Insight comment: It is important that those responding to this consultation provide ample feedback on the risks and benefits of the three tariff options to both suppliers and consumers (and which consumers) in order to ensure that Ofgem positively develops its modelled approach to minimise the margin of under or over-recovery. Though the potential of having bills with zero standing charge tariffs has some appeal, it will be important to understand who will gain from them, and for whom these will have no significant benefit. Great care and attention must be particularly paid to vulnerable consumers, even if these tariffs are optional.

2 Background

Standing charges are fixed charges unrelated to energy use and have been a part of energy bills for as long as there has been a retail energy market. Standing charges recover the 'fixed' costs of the system (i.e. costs that do not vary by energy use). These include suppliers' fixed operational costs of serving each consumer, the cost of network upgrades and maintenance necessary to keep all consumers connected and fund the technologies to drive progress towards net zero targets. Standing charges also go towards the cost of government programs, including the provision of environmental and social policy schemes supporting energy efficiency improvements in homes and businesses, helping vulnerable people and encouraging the uptake of renewable technologies. These are costs that cannot be avoided and that must be paid for.

Ofgem initially launched its [review of standing charges](#) in late 2023, gathering attitudes toward standing charges and the consumer perception of how these are added to their electricity and gas bills. Garnering thousands of responses from consumers, the conversation has since expanded, with a further [call for input](#) in August 2024 which set out some potential alternatives to how standing charges could be applied in order to potentially meet feedback from consumers who would prefer to pay solely for their energy based on use (unit rates) rather than also pay a standing charge.

Some of the conclusions from the call for input included that Ofgem would not shift costs from standing charges to unit rates for all customers under the energy price cap given the potential harm to some vulnerable customers; that it would review the recovery of system wide energy costs; and that it would consult on zero standing charge options under the existing price cap, as discussed below.

The regulator considers there is a case for change, in recognition of the significant response to the 2023 review, and cited that the need for greater diversity in the tariffs available to consumers needs to be addressed, particularly as around 80% of consumers currently sit on a Standard Variable Tariff (SVT). The regulator noted that to introduce a new variant under the current price cap mechanism, the unit rates on a

zero standing charge will have to be higher than the current cap. It also expects that under this variant, consumers would have to opt-in to it, rather than it replacing the default.

3 Tariff options

Within the consultation, Ofgem considers three different potential tariff structures, all of which would see consumers paying an increased unit rate compared to the existing energy price cap to account for both the typical costs included in the unit rate, as well as those currently recovered in standing charges.

1. Single rate tariff structure

A single rate tariff structure includes one unit rate price, regardless of consumption.

2. Falling block tariff structure

A falling block tariff structure includes multiple blocks of defined consumption thresholds, where the unit rate for the first block of consumption (from zero kWh to the first threshold) is a higher unit rate than that of the remaining consumption blocks.

3. Rising block tariff structure

A rising block structure works in the same way. However, the first block of consumption is the lowest unit rate price of the remaining consumption blocks.

3.1 Modelling

Ofgem's initial hypothetical modelling is underpinned by an assumption that a revenue gap will appear for suppliers with customers who opt-in to this option. This is because it is more likely that the customers who choose a no standing charge option will be low consumption users, below the Typical Domestic Consumption Value (TDCV). Therefore, Ofgem's high-level methodology is:

- Current price cap rates are used to convert the standing charge to a unit rate value for a household at TDCV consumption.
- This generates an initial tariff structure that would be revenue-neutral if the mean use of all consumers on this tariff was the TDCV.
- As stated above, as consumers that are likely to select this tariff will use less than the TDCV, it has created potential consumption scenarios of those on the tariff. See Figures 1 and 2 below, demonstrating two different consumption scenarios, each with 1mn consumers on the variant.
- Applying these consumption patterns provides an example revenue gap (at 1mn customers on the tariff) that could emerge from consumers being on this tariff. That revenue gap can then be 'recycled' back onto the unit rate to enable these costs to be recovered.

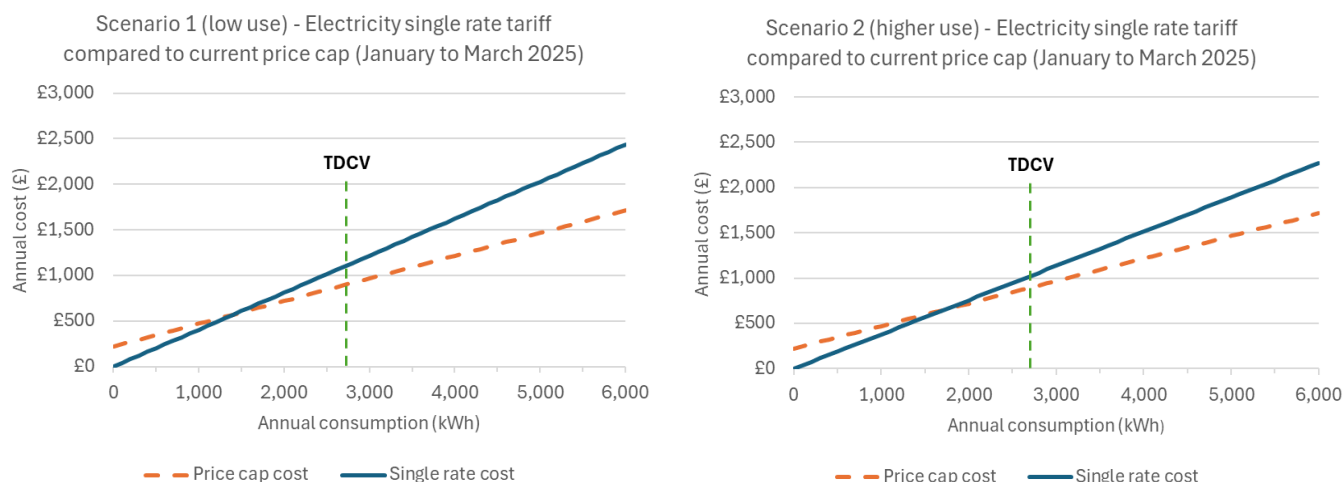
Scenario 1 has lower consumption – this aims to represent a proportion of vacant properties as well. While it still includes 1% of households at 0kWh, this is as a proxy for households that may be eligible and consume somewhere between 0 and 1,100kWh. Scenario 2 has assumed higher consumption. Both scenarios include consumers that are at TDCV consumption. As is shown in the examples that follow, these consumers would likely be paying more to be on the variant than they would on the existing price cap.

3.1.1 Single rate tariff

Below are two scenarios modelled by Ofgem, based on its assumptions. The scenario 1 (low use) and scenario 2 (higher use) graphs compare the annual cost of energy on the zero standing charge price cap variant to the current price cap (January to March 2025) using a single rate tariff structure for electricity.

Though this alert focuses on the electricity side, the consultation also models for gas usage, with the core message of zero standing charges remaining the same for both fuels.

Figure 1: Low and high usage scenarios, comparing costs between current cap and zero standing charge, single rate tariff option



Source: Ofgem

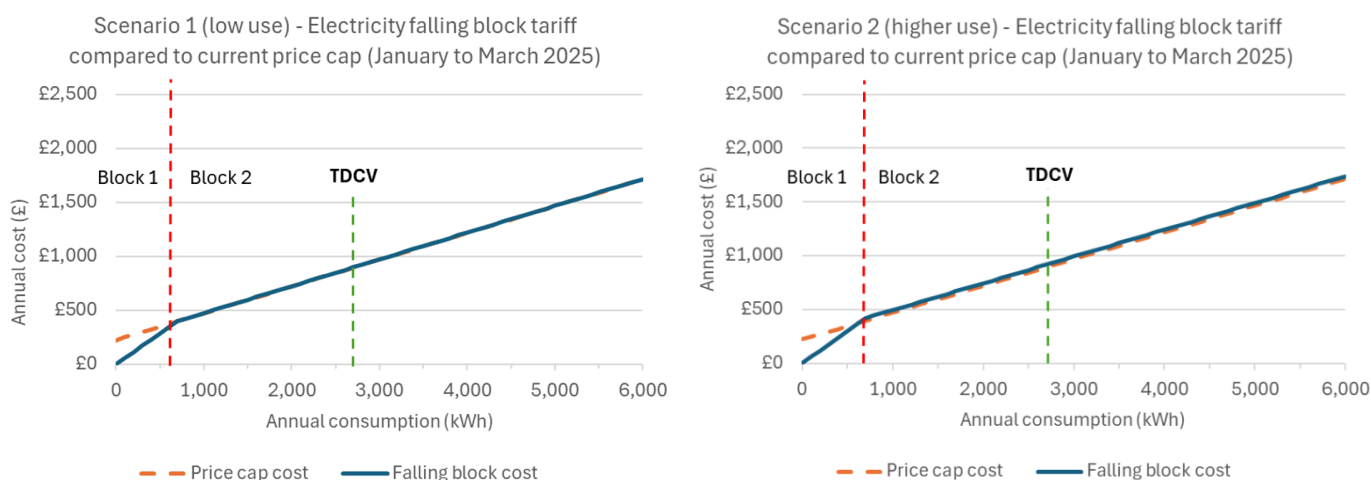
Ofgem noted that this interception point is at relatively low consumption levels: somewhere between the lowest 10 and 25% of consuming households. It recognised that overall cost may not be the only reason that consumers may choose this tariff, the additional cost that consumers would pay at typical consumption or above would be significant and would likely discourage many from choosing it.

This is a main consideration for this tariff structure, as in order for the tariff to work without leading to overall under recovery, it requires enough customers to pay more to balance out those that would pay less. On the single rate tariff, that could be a difficult balance to achieve.

3.1.2 Falling block tariff

A falling block tariff means that a consumer's first 'block' of consumption is priced at a higher unit rate, and once a certain amount of energy is used, the unit rate falls to a lower level. Part of this consultation involves Ofgem seeking views on how many blocks to use, what levels of consumption each block should represent (the time periods associated with this consumption), and what the unit rates of each block should be. It is currently basing its modelling on a two-block structure. For the example blocks, it has chosen 0 to 700kWh of annual electricity use for the first block (0 to 3,000 kWh for gas), and consumption above 700kWh (3,000 kWh for gas) for the second block.

Figure 2: Low and high usage scenarios, comparing costs between current cap and zero standing charge, falling block tariff option



Source: Ofgem

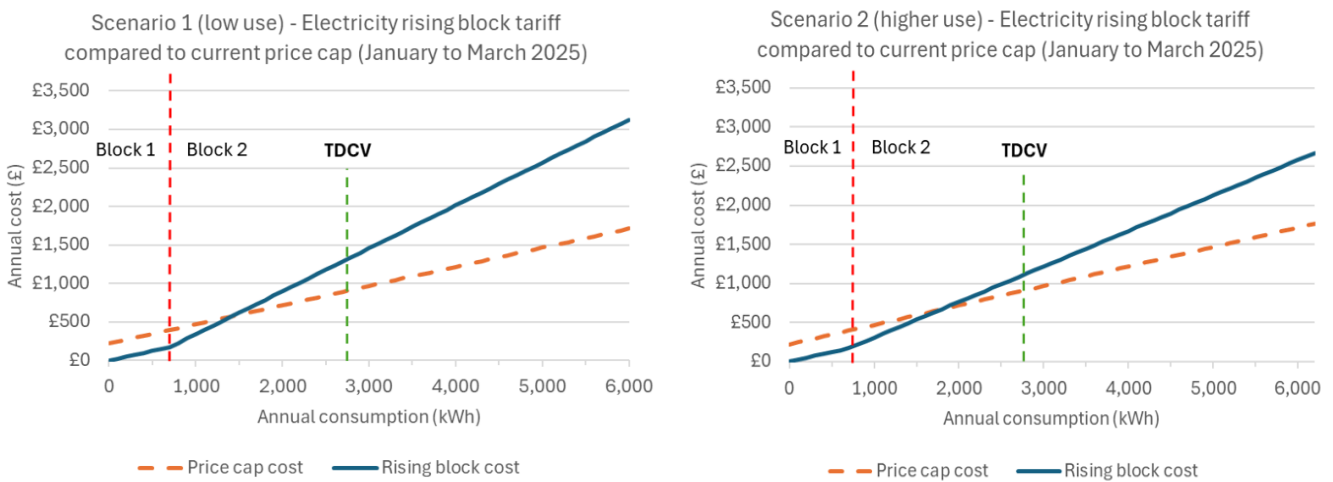
Most households would consume within the first block levels, which fits with an important design consideration that these costs should still be recovered on the whole.

For this tariff structure, there is a much lower under recovery risk when compared with the single rate tariff as most consumers will consume to the levels of the first block (electricity: 0 to 700kWh; gas: 0 to 3,000kWh) and therefore still pay the costs of the standing charge.

3.1.3 Rising block tariff

A rising block tariff is the opposite of a falling block, meaning that under a rising block tariff the first block of consumption is priced at a lower unit rate, and once a certain amount of energy is used, the unit rate rises to a higher level. In the examples, there are similar design considerations to the falling block, including a two-block structure and unit rates changing after 700kWh of electricity consumption and 3,000kWh of gas consumption. However, for the rising block, the standing charges costs are added to the unit rate of the second block. This keeps the unit rate low for the first block but does result in a greater under recovery risk (see Table 1). Furthermore, higher use consumers are less likely to choose this tariff as the second block of consumption rises steeply, which would in turn further decrease the likelihood that under recovery would balance out.

Figure 3: Low and high usage scenarios, comparing costs between current cap and zero standing charge, rising block tariff option



Source: Ofgem

3.1.4 Revenue Gap recycling

Based on the modelling of the scenarios carried out by Ofgem, it is likely that a revenue gap will emerge between what suppliers would recover under the existing price cap rates and what they would recover with a zero standing charge variant. Therefore, the unit rates on the zero standing charge tariff need to be increased further in order to close this revenue gap. This can be seen by the hypothetical figures in the table below based on an initial under-recovery at TDCV for 1mn consumers. This provides a strong illustration of the potential costs to suppliers and consumers under each tariff and scenario.

Table 1: Electricity unit rate

| Tariff option | Electricity Scenario | Initial under recovery at TDCV (1 million consumers) | Unit rate after correction for initial under recovery | Second block unit rate | Under contribution at 1,100kWh/year per customer (10th percentile) | Over contribution at 2,700kWh/year per customer (TDCV) | Customer contribution break-even point (annualised) |
|---------------|-------------------------|--|---|------------------------|--|--|---|
| Single Rate | Scenario 1 (low use) | £106mn | 41 pence/kWh | | £49 | £202 | 1,414 kWh |
| | Scenario 2 (higher use) | £81mn | 38 pence/kWh | | £80 | £128 | 1,715 kWh |
| Falling Block | Scenario 1 (low use) | £2mn | 57 pence/kWh | 25 pence/kWh | £2 | £2 | 693 kWh |
| | Scenario 2 (higher use) | £22mn | 60 pence/kWh | 25 pence/kWh | £25 | £25 | 630 kWh |
| Rising Block | Scenario 1 (low use) | £142 million | 25 pence/kWh | 56 pence/kWh | £99 | £395 | 1,421 kWh |
| | Scenario 2 (higher use) | £102 million | 25 pence/kWh | 45 pence/kWh | £141 | £188 | 1,785 kWh |

Source: Ofgem

4 Additional considerations from Ofgem

One option being considered is whether suppliers that are making innovative standing charge offers to their customers would be exempt from offering the price cap variant. This would encourage suppliers in bringing about different models that both work commercially, as well as work in consumers' interest.

In order to make this effective, Ofgem would be expected to develop a framework for determining whether a supplier's alternative offering has met the objectives of sufficiently reducing standing charges for consumers. Alongside this, the regulator would also need to develop a process for granting exemptions to each supplier that sought one. Should Ofgem ultimately decide that the price cap route would not be in consumers' interest, then it would expect to revisit the option to mandate that suppliers offer a zero standing charge tariff in the fixed market.

Ofgem, therefore, welcomes feedback on how best to ensure restraint on unit pricing when mandating a fixed term tariff.

4.1 Risk

Though these tariff structures serve to benefit consumers in having a greater sense of control over their bills while still contributing to their fixed costs, the scenarios are built on the basis of assumptions and scenarios, with actual consumer behaviour potentially differing in reality.

There are significant uncertainties for Ofgem in how many consumers will opt into the variant and what consumption those consumers will have. Depending on the tariff structure chosen, deviation from the modelled assumptions could potentially result in either under-recovery of suppliers' fixed costs, to their detriment, or over-recovery to the detriment of consumers.

As suppliers have varying portfolios, and as such the risk to each supplier will likely be different, a suggested measure to address this would be to include an initial risk premium into the price cap variant which would add increased costs to the variant to cover the risk of potential under contribution of fixed costs should Ofgem's assumptions be inaccurate. An alternative to the risk premium could be to start the price cap variant cautiously, by designing it based on the assumption of lower consumption, and adjusting it over time to more closely match actual consumption patterns on the variant. Both of these measures increase the risk of over contribution from consumers, however.

The introduction of an initial true-up would see any over-recovery paid back to consumers through lower rates at the following price cap setting. Ofgem considers this would likely require several periods in order to settle on an enduring level at which over or under recovery is minimal, and the true up could then be removed.

5 Next steps

The consultation closes on 20 March 2025. Depending on its review of the responses to this consultation, Ofgem will issue a statutory consultation with the preferred approach for a new price cap variant. If implemented, this would be available from next winter 2025-2026 for consumers to opt in to.



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