IDEAL ECONOMICS

The case for a market investigation reference of the supply of gas and electricity to non-domestic consumers

by

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Abbreviations used in this paper:

AEC: Adverse effect on competition

CMA: Competition and Markets Authority

CoT: Change of tenancy

EBIT: Earnings before interest and tax

I&C: Industrial and commercial

MIR: Market investigation reference

OoC: Out of contract

PCW: Price comparison website

SLC: Standard licence condition

SME: Small and medium-sized enterprise

TPI: Third party intermediary

VAT: Value added tax

About the author

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Summary

In its Energy Market Investigation in 2016 the Competition and Markets Authority (CMA) identified various features of the retail supply of gas and electricity to SMEs that adversely affected competition and led to customers paying higher prices. The CMA introduced a number of measures aimed at remedying this.

In March 2023 the Chief Executive of Ofgem, the energy regulator, made a commitment to the then Chancellor of the Exchequer, Jeremy Hunt, that Ofgem would consider referring this market back to the CMA for a fresh investigation if it had reasonable grounds to suspect that competition wasn't effective. The CMA's wide-ranging powers to obtain information and impose remedies mean a market investigation is the only way of resolving deep-seated competition problems.

Ofgem conducted a review of the market which concluded that it was still not functioning effectively. It said "We have received numerous reports that the non-domestic market is not delivering to our expectations, with accounts of customers struggling to contract with energy suppliers, poor customer service, and larger price hikes than seem necessary." However, Ofgem made no mention of referring the market to the CMA.

In fact Ofgem had not directly considered any of the features of the market that the CMA found adversely affected competition, notably the barriers to customers accessing and assessing information, which hinder them considering and selecting a new supplier offering a lower price. Thus, for example, it considered price transparency only in terms of the information in customers' own bills rather than information about alternative tariffs. It also looked at the effects of competition only in terms of customer service, not the level of prices. As such the measures it introduced will have negligible effect on competition or prices.

The criteria for a fresh market investigation reference are clearly met, notably the scale of the adverse effect on competition and the availability of appropriate remedies. The fact that the CMA has looked at this market before means that a fresh market investigation could almost certainly be concluded within a year and the CMA would be expected to ensure its remedies were effective this time.

Scale of the problem

The CMA's provisional finding in its market investigation was that SMEs' energy bills were 18% too high, amounting to detriment of £500 million p.a. for SME customers of just the 'Big Six' energy suppliers. Although in its final report it disregarded part of the detriment because of issues with the data, leading to an estimate of £220 million p.a., of which £183 million p.a. related to micro-businesses. Noting also that several independent suppliers had bigger market shares than some of the Big Six suppliers, it said this figure was a "lower bound" estimate of the overall detriment.

Features leading to the adverse effect on competition

The structure of tariffs is likely to make it difficult for business customers to assess alternative tariffs' value for money, with the size and variability of standing charges making it difficult to compare them. This is compounded by customers' difficulty understanding the relationship between their energy consumption and their bills under their current tariff, which is also accentuated by high and variable standing charges.

These factors confer market power on suppliers who exploit their greater knowledge and understanding of the market by negotiating prices individually rather than making their best offers widely known. This makes it difficult for customers even to access information about alternative tariffs.

Customers' confusion and suppliers' lack of transparency about their best offers lead to the involvement of third party intermediaries (i.e. brokers). Their commission payments exacerbate the complexity of bills and tariffs, further reducing customer engagement.

Potential remedies

There are a number of potential remedies that the CMA didn't consider previously:-

1. A cap on the standing charge in energy tariffs. This would simplify bills and make it much easier for customers to compare tariffs as they would only need to know the unit rate to do that. This is particularly the case because such a cap would be substantially below the current level of standing charges.

   The CMA said it didn't impose a cap on non-domestic tariffs following its market investigation partly because the heterogeneity of microbusinesses and the variation in consumption levels would have made it complex to do so. That objection doesn't apply to a cap on just the standing charge, which the CMA appears not to have considered.

   The level of a standing charge cap would be specified for different meter sizes so would vary between groups of customers but would be fixed for each customer.

2. Mandating Ofgem to publish guidance on the competitive level of the unit rate. This would supplement a standing charge cap and help business customers in their negotiations with suppliers by informing them of the level of unit rate they could expect to achieve.

3. Eliminating any obstacles to smart meters being installed and converted to pre-payment meters for non-domestic customers as they can be for domestic customers. This would overcome many of the risks to suppliers of taking on new customers and avoid the need for security deposits, up-front payments and higher ongoing payments. In doing so it would address the problem that a number of customers (those perceived as riskier, such as independent pubs) struggle to secure any energy contracts at all.

Non-domestic customers other than businesses

The above issues may be expected to arise not just in relation to businesses but also other non-domestic customers, such as charities, churches, NGOs and public institutions and facilities, including schools, GPs' surgeries and community centres.

Effect on carbon emissions and energy security

A standing charge cap would also lead to a reduction in carbon emissions and improve the U.K.'s energy security. Some costs now recovered through the standing charge such as network costs would instead be added to the unit rate, which would lower demand for energy and thereby reduce the burning of fossil fuels and the investment needed in generation and network capacity.

Market investigation references

1. Market investigations are detailed examinations conducted by the Competition and Markets Authority (CMA) of whether there is an adverse effect on competition (AEC) in the markets referred and, if so, what remedial action might be appropriate. The CMA has wide information gathering powers in market investigations and is able to compel persons to attend to give evidence and businesses to provide documents and other information. It also has wide ranging power to impose remedies following a market investigation, including structural remedies such as divestment; behavioural remedies; measures to improve the information available to customers; and recommendations to government to change policy or regulation.

2. Under the Enterprise Act 2002 market investigation references (MIRs) may be made where there are reasonable grounds for suspecting that a feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or part of the UK.[1]

3. References will only be made when that test and each of the following criteria have been met:-
   - It would not be more appropriate to deal with the competition issues identified by applying the Competition Act (1998)[2] or other powers available to sectoral regulators.
   - It would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference.
   - The scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response to it.
   - There is a reasonable chance that appropriate remedies will be available.[3]

4. Note that the following factors are relevant to the scale of the suspected problem:-
   - The size of the market.
   - The proportion of the market affected by the feature giving rise to adverse effects on competition.
   - The persistence of the feature giving rise to adverse effects on competition.[4]

5. Both the CMA and the sector regulators (in this case Ofgem, the gas and electricity markets authority) may make market investigation references. Ministers also have a reserve power to make references.[5]

6. A designated consumer body may also make a super-complaint if any feature, or combination of features, of a market in the U.K. for goods or services is or appears to be significantly harming the interests of consumers. Regulators have a duty to respond to super-complaints made to them that concern the sector they regulate.[6] Designated consumer bodies include Which? and Citizens Advice.

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[1] *Market Investigation References* Office of Fair Trading paragraph 1.6.
[2] The Competition Act (1998) prohibits agreements, which have the object or effect of preventing, restricting or distorting competition, and abuses of a dominant position. (*Market Investigation References* Office of Fair Trading paragraph 2.2.)
[3] *Market Investigation References* Office of Fair Trading paragraph 2.1.
[4] *Market Investigation References* Office of Fair Trading paragraph 2.28.
[5] *Market Studies and Market Investigations: Supplemental guidance on the CMA's approach* Competition and Markets Authority (January 2014, revised July 2017) paragraphs 1.18, 1.21.
[6] *Regulated Industries: Guidance on concurrent application of competition law to regulated industries* Competition and Markets Authority (March 2014) paragraph 4.22.

The CMA's Energy Market Investigation (2016)

Adverse effect on competition (AEC)

7. This market investigation encompassed the retail supply of gas and electricity to both domestic (i.e. residential) and non-domestic customers. Ofgem decided the terms of reference for the investigation of the non-domestic element, which is what this report is concerned with, and restricted it to micro-business customers.[7] The CMA noted that in various places its report refers to evidence relating to different groups of businesses, including SMEs.[8,9] However, the same issues may be expected to also in relation to non-domestic customers other than businesses, such as charities, churches, NGOs and public institutions and facilities, including schools, GPs' surgeries and community centres.

8. In its Energy Market Investigation the CMA found that a substantial number of microbusinesses were achieving poor outcomes in their energy supply. Suppliers' margins were generally higher in the SME markets than other markets and average revenues were substantially higher (beyond what was justified by costs) on the default tariffs that less engaged microbusiness customers ended up on[10].[11]

9. The CMA therefore believed that the less engaged customers on these tariffs were not exerting sufficient competitive constraints on energy suppliers, particularly as regards the various types of default tariffs that customers could be automatically moved on to if they either:-
   (i) had not actively engaged with their energy supplier (auto-rollover and replacement contracts) or
   (ii) were receiving energy supply but had not agreed a contract (deemed and Out of Contract - OoC - tariffs).[12]
   (See Annexe 1 for a description of all non-domestic tariff types.)

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[7] *Decision to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain* (2014) Ofgem, pp.13-14.

[8] *Energy Market Investigation Final report* (June 2016) Competition and Markets Authority (CMA) (hereafter referred to as 'CMA final report') paragraph 16.3.

[9] Ofgem defined a microbusiness as a non-domestic customer that met at least one of the following criteria:-
(a) it employs fewer than 10 employees (or their full-time equivalent) and has an annual turnover or balance sheet no greater than €2 million; or
(b) it consumes no more than 100,000 kWh of electricity per year; or
(c) it consumes no more than 293,000 kWh of gas per year. (CMA final report paragraph 16.4)
The CMA said Ofgem had reported that microbusinesses accounted for an estimated 1.6 million electricity meter points and 0.55 million gas meter points. (CMA final report paragraph 16.7).
The CMA pointed out that information was not always specifically available for microbusinesses and its report refers to evidence relating to:-
- Non-domestic customers (i.e. all business customers, including those in the I&C, i.e. industrial and commercial, markets);
- SMEs (smaller businesses);
- Microbusinesses. (CMA final report paragraph 16.5)

[10] A significant proportion of microbusiness customers were on default contracts (CMA final report paragraph 17.179).

[11] CMA final report paragraph 16.134.

[12] CMA final report paragraph 16.134.

The features of the market that were found to adversely affect competition

10. The CMA identified a combination of features of the markets for the retail supply of gas and electricity to SMEs in Great Britain that gave rise to an adverse effect on competition (AEC) through an overarching feature of weak customer response from micro-businesses. These in turn gave suppliers market power over their inactive microbusiness customer base which they were able to exploit through their pricing policies or otherwise. These features acted in combination to deter microbusiness customers from engaging in the SME retail gas and electricity markets, to impede their ability to do so effectively and successfully, and to discourage them from considering and/or selecting a new supplier that offers a lower price for effectively the same product.[13]

11. These features were[14]:-

    (a) Customers had limited awareness of and interest in their ability to switch energy supplier (i.e. a lack of engagement), arising from:-

        (i) The homogeneity of gas and electricity, which meant an absence of quality differentiation.[15]

        (ii) The role of traditional meters and bills, which gave rise to a disparity between actual and estimated consumption. This could be confusing and unhelpful to customers in understanding the relationship between the energy they consume and the amount they pay.[16,17] The CMA said the full roll-out of smart meters over the next five years might have a potentially significant positive impact on engagement.

    (b) Customers faced actual and perceived barriers to accessing and assessing information arising, in particular, from:-

        (i) A lack of price transparency concerning the tariffs that were available to microbusinesses resulting from:-

            - Many microbusiness tariffs not being published.[18]

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[13] CMA final report paragraph 16.135.
[14] CMA final report paragraph 16.136.
[15] The CMA explained in relation to domestic consumers why this was a characteristic of energy consumption that led to limited awareness of and interest in their ability to switch energy supplier. On the one hand, it meant that price was the most important consideration in the choice of supplier and tariff. On the other hand the fact that there was no quality differentiation of gas and electricity might fundamentally reduce consumers' enthusiasm for, and interest in, engaging in the energy markets, leading to customer inertia. (CMA final report paragraphs 9.142-9.145.)
[16] The CMA also said traditional meters and bills were complex in their own right. It said they "may be leading to a lack of visibility of energy consumption for many microbusiness customers". It added that this lack of visibility and high complexity might deter customers from considering whether to switch energy supplier. (CMA final report paragraph 16.53).
[17] In relation to domestic customers the CMA said further that they give rise to inaccurate and confusing information for customers which dissuades them from engaging. Traditional meters are not very visible or immediately informative, as a result of which consumers are generally not aware of how much gas and electricity they consume. They are read infrequently and the use of estimated readings and estimated usage adds considerably to the complexity and opacity of bills. Traditional meters also do not report the same unit of usage as bills. (CMA final report paragraphs 9.146-9.148, 9.156).
[18] The CMA also said that many suppliers published their deemed contract prices and some published other variable contract prices but these were unlikely to be the best deals available. (CMA final report paragraph 16.58.)

- A substantial proportion of microbusiness tariffs being individually negotiated.

- The nascent state of PCWs for non-domestic customers.

(ii) The role of TPIs[19]:-

- A number of complaints had been made by customers about alleged TPI malpractice, which might have reduced the level of trust in all TPIs and discouraged engagement more generally.[20]

- The CMA had noted a lack of transparency[21] as well as incentives not to give customers the best possible deal. It was concerned that customers were not aware of this and therefore did not take steps to mitigate it (for example, by consulting more than one TPI or seeking other benchmark prices).[22] This was exacerbated by the lack of easily available benchmark prices and the fact that many tariffs were not published.

(c) Some microbusiness customers were on auto-rollover contracts (where customers had signed up for an initial period at a fixed rate, with an automatic rollover for a subsequent fixed period at a rate they had not negotiated with no exit clause), and were given a narrow window in which to switch supplier or tariff, which might limit their ability to engage with the markets.[23]

NB The CMA also expected any competitive constraint on the pricing of deemed and OoC tariffs[24] to be weak. It said this was illustrated by the fact that prices for these

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[19] TPIs are intermediaries in the supply chain between the energy supplier and the retail customer. They can include online TPIs (e.g. PCWs) and offline TPIs (e.g. brokers) (CMA final report paragraph 17.260 footnote 117). References to TPIs here henceforth refer to (offline) brokers rather than (online) PCWs.

[20] The CMA said many smaller customers appeared to distrust TPIs. (CMA final report paragraphs 16.62 (b), 16.77.). It said this was partly driven by long-standing concerns about the behaviour of some TPIs which had emerged from a variety of sources (e.g. complaints to official bodies and a BBC investigation) (CMA final report paragraphs 16.63). It also said it had received inconclusive evidence regarding alleged TPI malpractice. While there were overall negative perceptions of TPIs among SME customers most customers who used them were satisfied with them (CMA final report paragraph 17.268, 17.269(a)).

[21] The CMA said non-domestic customers did not seem to understand well the process by which commission was paid to TPIs (it was often added to the unit rate paid, with the rate determined by the TPI). Most small business customers who had used a broker did not report that they had been charged for that service. (CMA final report paragraphs 16.64, 17.269(b)).

[22] The CMA cited a report which pointed out that TPIs might not be presenting the most advantageous offers to SMEs because suppliers were skewing commission payments towards the deals they wanted to sell. (CMA final report paragraph 17.269(c)). It also said several parties had reported that TPIs might face incentives to sell certain products, which would result in non-domestic customers not being offered the most appropriate rates. Similarly, many TPIs would not cover all suppliers in the market. If customers were not aware of these issues then they would not see an incentive to take countervailing action (e.g. multi-homing), and as a result competition between TPIs might not work effectively. (CMA final report paragraph 16.65).

[23] Since 2013 the largest suppliers had gradually withdrawn auto-rollover contracts as a result of pressure from Ofgem and the government but some of the smaller ones (who still accounted for a significant share of the supply of gas to microbusinesses) hadn't. A customer effectively had a 30-day period to switch tariff and/or supplier and, if it did not do so, would not be able to switch for the next year. (CMA final report paragraphs 16.94-16.97.)

[24] The CMA said these tariffs applied to "only a minority" of customers. (CMA final report paragraph 16.100). However, Ofgem said more recently that the number of customers on deemed rates alone was "not insignificant": 330,000 for electricity (12% of all meter points in 2022) and 72,000 (10%) for

types of tariff were significantly higher than other tariff types. Given the level of prices it said that in a well-functioning market it would expect to see customers stay on these tariffs for transitory periods but many customers stay on them for a substantial period of time[25]. The CMA found the higher prices were only partly justified by higher costs (in particular, high levels of bad debt).[26]

Effect of transparency on engagement

12. As the CMA noted, limited engagement was at least partly due to the lack of transparency. "Transparency is an important factor in facilitating engagement."[27] Low visibility of market prices might result in lower customer awareness that there were better deals available so customers might be less likely to try to switch supplier or tariff. For customers that did decide to investigate their options, a lack of transparency might increase their search costs. If a customer ended up in a negotiation with a supplier, it might be in a weak position if it had limited knowledge of its other options in order to benchmark offers.[28]

13. The CMA also said there were indications that supplying medium-sized microbusinesses might be more profitable than supplying larger SMEs. It said that to the extent this was true, it might be linked to lower engagement among microbusinesses than larger SME customers. It would also be consistent with low transparency increasing switching costs, as these costs would be higher (relative to the cost of energy) for medium-sized microbusinesses than larger SMEs.[29]

Detriment

14. The CMA identified customer detriment in the form of gas and electricity microbusiness customers paying higher prices than would be the case in a well-functioning market.[30]

15. The CMA's provisional findings report had calculated detriment of approx. £500 million p.a. for the SME customers of the Big Six energy firms[31], equating to approximately 15% of their revenues, which suggests that detriment amounted to 18% of SMEs' energy bills. Profits in excess of the cost of capital comprised approx. £325 million of this, with approx. £175 million related to relative inefficiencies. The EBIT margin for these firms in the SME markets was 8.4% compared with 3.3% in the domestic retail markets and 2% in the I&C markets.[32]

16. However, the final report disregarded the detriment relating to inefficiencies because of issues with the data. Thus it estimated the detriment to SME customers of the Big Six energy suppliers at approx. £220 million p.a., of which approx. £183 million p.a. related to micro-businesses. It said that basing this estimate solely on the profits in excess of the cost of capital was "a conservative assumption". It also noted that it did not take into account any excess profits of independent suppliers even though several had greater

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gas. (Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.38.)

[25] It said the median duration of micro-business customers' stay on deemed and OoC tariffs was over one year.

[26] CMA final report paragraphs 16.99-16.111.

[27] CMA final report paragraph 16.75.

[28] CMA final report paragraphs 16.56, 16.75.

[29] CMA final report paragraph 16.120.

[30] CMA final report paragraph 16.140.

[31] The six large energy suppliers at the time of the CMA's energy market investigation were: Centrica, EDF Energy, E.ON, RWE, SSE and Scottish Power.

[32] CMA final report paragraphs 16.141-16.143.

market shares than some of the Big Six so the CMA said the revised estimate was "a lower bound estimate".[33]

17. The CMA did not attempt to quantify any possible detriment arising from non-price sources of detriment such as impacts on innovation or quality of service.[34]

The CMA's remedies

18. The CMA introduced a number of measures designed to help microbusiness customers engage.

Price transparency remedy

19. The CMA required energy suppliers to disclose prices for all contracts on offer for a specific sub-segment of microbusinesses[35] via online quotation tools on suppliers' websites or third party online platforms such as PCWs,[36] which were to be prominently signposted on their websites[37]. However, the fact that many tariffs were not previously published online by suppliers[38] suggests they did not believe it was in their interest to do that. Obliging suppliers to publish them is unlikely to have altered their underlying incentive not to. This is discussed further in paragraph 65 below.)

20. Suppliers would be permitted to contract at a price below the published rate.[39] As one supplier pointed out, suppliers could circumvent the remedy by disclosing relatively high prices and then offering lower prices to customers who negotiated. The CMA responded that suppliers would have an incentive to disclose competitive prices to win new business and that the remedy would not result in higher prices.[40] In fact the objection was not that it would result in *higher* prices but that low prices would only result from negotiation, as before, so this measure would make little difference. Indeed the CMA was aware that many suppliers did publish some default prices but these were unlikely to be the best ones (see footnote 18 above).

21. The CMA thought it would also enhance TPIs' roles (in particular PCWs' roles) in helping microbusiness customers access and assess information and thereby facilitate the development of PCWs.[41] It also believed it would constrain TPI conduct (in terms of potential or alleged malpractice) by enabling customers to assess and verify online whether the prices they were quoted by TPIs were reasonable. This would act as a competitive constraint on TPIs, which would be incentivised to offer competitive quotes.[42,43] Again, this would have been dependent on suppliers publishing competitive prices.

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[33] CMA final report paragraphs 16.145-16.152.
[34] CMA final report paragraph 16.155.
[35] The 'Relevant Segment', generally smaller microbusinesses and those with lower electricity and gas consumption levels.
[36] CMA final report paragraphs 17.18-17.26.
[37] CMA final report paragraph 17.57.
[38] CMA final report paragraphs 17.23
[39] CMA final report paragraphs 17.56.
[40] CMA final report paragraph 17.28(b)..
[41] CMA final report paragraph 17.266.
[42] CMA final report paragraph 17.267
[43] For these reasons the CMA decided against a remedy that would have required TPIs to disclose to customers:-
(a) The extent to which they cover the whole market, e.g. highlighting those suppliers they do and don't have agreements with
(b) How they are paid for their services, e.g. by commission from energy suppliers.

Auto-rollover remedy

22. In order to increase the ability of customers on auto-rollover contracts to switch contracts or suppliers the CMA:-

- Prohibited termination fees and/or a 'no exit' clause during the 'roll-over period' (the contract period customers are 'rolled-over on to) and prohibited termination fees on OoC and evergreen contracts too[44]. (See Annexe 1 for a description of all non-domestic tariff types.)

- Allowed microbusiness customers to give a termination notice to their supplier at any time during the initial fixed-term period and the roll-over period.[45]

Ofgem programme to promote microbusiness customers' engagement

23. The CMA recommended that Ofgem establish an ongoing programme to identify, test and implement measures by which suppliers would provide microbusiness customers with information to prompt them to engage in the energy markets with a view to switching contract or supplier.[46]

The database remedy

24. Energy suppliers were required to disclose certain details of their microbusiness customers that had been on a default contract for three or more years and the CMA recommended that Ofgem retain, use and disclose this data (via a centrally managed database) to rival suppliers. This was to enable rival energy suppliers to identify disengaged microbusiness customers and to contact them to try to win their custom.[47]

Price cap

25. The CMA decided against implementing a price cap to protect microbusinesses that were unable to engage. It considered its package of other remedies would be adequate in addressing the AEC and associated detriment. It also noted that the complexity of implementing, monitoring and enforcing a price cap remedy and its associated costs to suppliers would be significantly increased by the heterogeneity of the microbusiness segment and the considerable variation in consumption levels among microbusinesses.[48]

Rollout of smart meters

26. The CMA also said that the full roll-out of smart meters over the next five years might have a potentially significant positive impact on engagement.[49]

(c) Whether they will provide the customer with the cheapest quote(s) among those firms with which the TPI has an agreement to supply customers, or only a selection of quotes.
(CMA final report paragraph 17.262)

[44] This achieves consistency with respect to termination fees on all default contracts as Standard Licence Condition 7.6 does not permit suppliers to charge termination fees on deemed contracts to non-domestic customers. (CMA final report paragraphs 17.137.)

[45] CMA final report paragraph 17.115-17.116, 17.128.

[46] CMA final report paragraphs 17.181, 17.183.

[47] CMA final report paragraphs 17.219, 17.220, 17.229.

[48] CMA final report paragraph 17.276.

[49] CMA final report paragraph 17.276.

[49] CMA final report paragraph 16.136 (a) (ii).

Ofgem's market review (2023)

27. Concerned about the behaviour of some suppliers as a result of reports from non-domestic customer groups and its own monitoring, Ofgem, the energy regulator, conducted a review of the non-domestic retail energy market, including a Call for Input.[50]

28. In March 2023 the Chief Executive of Ofgem made a commitment to the then Chancellor of the Exchequer, Jeremy Hunt, that Ofgem would consider making a market investigation reference if it had reasonable grounds to suspect that competition in the non-domestic energy market wasn't effective[51].

29. The market review report published in July 2023 duly showed that the market was not functioning effectively. It said: "We have received numerous reports that the non-domestic market is not delivering to our expectations: with accounts of customers struggling to contract with energy suppliers, poor customer service, and larger price hikes than seem necessary."[52]

30. Ofgem said it had "needed to identify if issues are temporary, or supplier specific, or whether they show more systemic market issues that may need a deeper market investigation or changes to our rules".[53] However, while it proposed a number of measures (see below) it didn't appear to conclude on whether the issues were systemic and required a deeper market investigation (such as would follow from a market investigation reference to the CMA) as it made no further mention of this.

31. Ofgem said many stakeholders had reported:-

    <u>Difficulties securing energy contracts</u>

    - Consumers struggled to secure any energy contracts. Where there were offers to contract to supply energy, stakeholders reported that they were offered unnecessarily high prices or suppliers made unreasonable requests for security deposits, up-front payments or other obligations in order to secure a contract.[54]

    <u>Large increases in bills and a lack of explanation for these</u>

    - Customers did not understand the reasons for some large increases to their bills, especially standing charges.[55] Similarly, Ofgem said that in many instances respondents experienced significant price hikes in both unit rates and standing charges, with no clear explanation why.[56]

    <u>Confusion about payments to TPIs</u>

    - Consumers were not always sufficiently aware of what they were paying to TPIs, such as energy brokers.[57]

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[50] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) p.1.
[51] Ofgem Letter from Jonathan Brearley to the Chancellor of the Exchequer 14 March 2023 https://www.ofgem.gov.uk/publications/update-non-domestic-market-review p.2.
[52] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) p.4.
[53] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) p.4.
[54] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.2. Similarly paragraph 2.26.
[55] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) p.7.
[56] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.10.
[57] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) p.7.

Deemed rates

- Suppliers charged very high deemed rates, with a large difference between the contracted rate and the deemed rate.[58]

Variation in standing charges

- Ofgem said that standing charges varied considerably across suppliers, driven in part by different elements included in the standing charge.[59] In fact it had earlier also said that *changes in* standing charges were very variable across suppliers too.[60]

Ofgem's conclusions on issues related to competition

Pricing 'transparency'

- Ofgem said "Clearly, there needs to be an improvement in pricing transparency".[61] It said "Currently, there is a lack of transparency and inconsistency [across suppliers] in how elements of consumers' energy charges are displayed in non-domestic bills, which can make it hard for consumers to understand their bills and what is driving energy costs."[62] Ofgem also said consumers particularly reported lack of transparency about changes to their contract charges.[63]

Deemed rates

- Ofgem said that, having collected data on deemed rates through Requests for Information, it was aware of some particularly high deemed rates.[64]

Effect on customer service

- Ofgem considered the effects of competition only in terms of customer service. Issues it considered related to this were: change of tenancy (covering the lack of consistency across suppliers as to which documents were required to demonstrate a change of tenancy - CoT - or occupier - CoO[65]); debt and disconnection processes; complaints handling and resolution; and access to TPI alternative dispute resolution.[66]

32. Thus Ofgem did not assess the market and the phenomena it observed in terms of any kind of competition framework. It did not directly consider any of the features that the CMA found adversely affected competition, notably the barriers to accessing and assessing information, which hinder them in considering and/or selecting a new supplier

[58] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.38.
[59] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.12.
[60] Ofgem Letter from Jonathan Brearley to the Chancellor of the Exchequer 14 March 2023 p.6.
[61] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.24.
[62] Ofgem *Best Practice Guide Non-Domestic Billing Transparency* (April 2024) p.4. Similarly paragraph 1.1.
[63] Ofgem *Best Practice Guide Non-Domestic Billing Transparency* (April 2024) paragraph 1.1.
[64] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.56.
[65] Ofgem said many responses to its call for information noted that customers who undergo a lengthy CoT process are exposed to deemed rates for longer. Some expressed concerns that suppliers deliberately obstructed the process, with a wide range of CoT requirements between suppliers. (Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.39).
[66] Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) Chapter 3 'Competition in the market and customer service'.

offering a lower price. Although it noted the high prices paid by customers on deemed contracts it also disregarded the effect of competition on the general level of prices.

Outcomes of the market review

33. Actions Ofgem has taken or is going to take that directly relate to competition are:-

TPI charges

34. Ofgem expanded its existing rule that requires clarity of TPI service fees in microbusiness contracts to all non-domestic customers. It said this would ensure all customers know what third party charges they are paying as part of their contract so they can see these separately to energy costs. This would apply to contracts signed from October 2024.[67]

Bill clarity

35. Ofgem has not mandated specific bill information[68] but has agreed a Best Practice Guide with consumer groups and suppliers whereby suppliers voluntarily agree to publish information on how certain groups of costs make up the unit rates and standing charges for illustrative customer groups.[69] The elements of this are summarised in the box below.

[67] Ofgem *Non-domestic Market Review Decision* (April 2024) pp.6,43.
[68] Ofgem said that the many different types of contracts offered in the non-domestic sector meant it was not appropriate for it to mandate specific bill information. (Ofgem *Non-domestic market review: Findings and policy consultation* July 2023 paragraph 2.24.)
[69] Ofgem *Non-domestic Market Review Decision* April 2024 p.7 and paragraphs 7.5-7.6.

According to the Best Practice Guide[1]:-

- *The unit rate and standing charge will be broken down into proportions of various groups ('buckets') of costs for illustrative customer groups. The cost buckets are commodity costs (the wholesale price of gas and electricity) and various non-commodity costs: (1) network and metering charges (2) environmental and social obligation costs (3) third party service fees (if applicable) (4) taxes such as the Climate Change Levy and VAT and (5) operating charges. Suppliers do not need to break down these individual costs in the bill itself but can if they wish.*
- *Suppliers can take a "layered approach" and provide general illustrative examples for different customer types. Customers could then use this information as a basis for further discussions with their supplier and request further information. The general information and illustrative examples could be shared, for example, on suppliers' websites and linked [to] on the bill, in fact sheets or other content such as videos.*
- *Suppliers are "encouraged" to provide the same information on their own websites, in addition to providing information which is applicable to their specific customer base.*
- *Suppliers could consider ways in which they might help their customers relate their energy usage to their bill, such as through graphs showing energy consumption.*
- *Suppliers would "ideally" provide a clear explanation to customers when any changes occur to the charges in their bills. Suppliers could also provide information on the changes on their website if they do not want to crowd the bill, so long as this is clearly explained on or with the bill (e.g. by providing a hyperlink to an explanatory page).*

The Best Practice Guide also highlights good practices some suppliers display in their bills, with the aim of sharing them in case other suppliers wish to adopt them.

36. However, this falls short of what is required in a number of ways:-

- It is unlikely to help customers understand the relationship between the energy they consume and what they pay and does not do anything to facilitate the provision of information about tariffs available from alternative suppliers.
- Customers would be able to gain an understanding of the reasons for changes in bills by comparing the make up of consecutive bills. However, this would be only approximate as breakdowns of bills are for 'illustrative customer groups' not each customer and many of the cost categories are composite (e.g. network and metering charges) so it would not be possible to pinpoint the reasons for changes.
- Customers will be unable to judge whether changes in the supplier's 'operating charges' are justified and they are likely to be less concerned with the reasons for changes in their bills than whether their bill represents good value.
- By providing lots of imprecise data it is possible that it will actually confuse customers rather than help them understand their bills and the reason for changes in them.
- There is a lot of leeway for suppliers to customise what they show so the information provided will continue to vary between suppliers.
- Some of what is suggested is dependent on suppliers' having an incentive to furnish their customers with good information. Unfortunately analysis of competition

suggests that is not the case (see the section 'The case for a new market investigation reference: (1) the adverse effect on competition' below).

Deemed rates

37. Gas and electricity Standard Licence Conditions 7.3 and 7.4 require the terms of deemed contracts not to be unduly onerous. They are unduly onerous if the revenue derived from supplying gas or electricity to the premises of the relevant class of customers significantly exceeds the supplier's costs of supplying gas or electricity. However, as the CMA noted, this(these) licence condition(s) appear to allow some latitude for suppliers to set some high prices for these tariffs and there is no equivalent licence condition for OoC tariffs although the competitive constraint on the pricing of OoC tariffs is weak, just as it is on deemed tariffs[70] (see paragraph 11(c) above).

38. Ofgem said it was investigating possible breaches of these licence conditions.[71]

39. Ofgem has issued guidance[72] to provide further clarity on compliance with these licence conditions. "Significantly exceeds" is taken to mean that the deemed rate is "much higher" than an equivalent (i.e. comparable) contracted rate and that this difference is not justified, for example by the increased costs the supplier faces in supplying deemed customers.[73]

40. The following box sets out how Ofgem will undertake this comparison of deemed and equivalent contracted rates.

[70] CMA final report paragraphs 16.99-16.110.
[71] Ofgem *Non-domestic market review: statutory consultation on licence changes* (December 2023) paragraph 7.10.
[72] Ofgem *Guidance on Deemed Contracts* (November 2023) https://www.ofgem.gov.uk/sites/default/files/2023-11/Guidance%20on%20Deemed%20Contracts.pdf
[73] Ofgem *Guidance on Deemed Contracts* (November 2023) paragraphs 2.22-2.23.

Comparison of deemed rates and equivalent contracted rates

This comparison will be against the supplier's own equivalent contracted rates rather than the rates of any other suppliers.[1]

Ofgem intends to assess whether deemed rates are unduly onerous on a case by case basis taking numerous factors into account, including:-

- *factors causing them to fluctuate such as volatility of energy prices*
- *rates in individual constituent time periods (e.g. months) within the overall time period (e.g. a year) over which the rates are being compared*
- *the differences and reasons for differences between the elements that make up standing charges, unit rates and margins*
- *whether the supplier's methodology in setting the deemed rates reflects "a clear, thought-out process" with consideration to the type of customer (e.g. SME, industrial and commercial – I&C) and their geographic location in comparison with their contract rates*
- *higher risk and costs associated with deemed rate customers due to, for example, bad debt, risk of non-payment, poor credit or not having had any contact with a customer in new premises.*[1]

Suppliers are required to ensure they have deemed rates applicable to relevant classes of customers, e.g. micro-business, SME and I&C, and groups of customers that have similar contract pricing based on consumption rates, meter classifications and/or location.[1]

Suppliers should review their deemed rates regularly. At least once a quarter is likely to be appropriate, possibly more frequently in times of significant market volatility.[1]

41. Ofgem said many stakeholders argued that there should be a numerical element to the definition, similar to the price cap for domestic consumers, or that deemed rates should be capped at a certain percentage higher than a supplier's equivalent contract rate.[74]

42. Ofgem said these approaches would not have been appropriate as it does not directly regulate suppliers' pricing in the non-domestic market.[75] However, it had previously explained that it regulates deemed contracts in order to protect customers from unduly onerous deemed rates.[76] Regulating contracts to protect consumers from unduly onerous rates but not regulating the rates themselves seems like a spurious distinction.

[74] Ofgem *Non-domestic market review: statutory consultation on licence changes* (December 2023) paragraph 7.3.
[75] Ofgem *Non-domestic market review: statutory consultation on licence changes* (December 2023) paragraph 7.3.
[76] Ofgem said it "regulate[s] deemed contracts as the nature of deemed contracts means that customers have no ability to choose; there is no negotiated contract in place between the customer and the supplier before they start consuming energy. This means that if consumers are on deemed contracts in which they are facing very high deemed rates there is little they can do about it, especially if they are unable to otherwise secure a contract… Therefore, we are of the view that it is appropriate that we protect customers from unduly onerous deemed rates through enforcement of this SLC." Ofgem *Non-domestic market review: Findings and policy consultation* (July 2023) paragraph 2.56.

43. In any case by issuing this guidance Ofgem *has* set a *de facto* price cap albeit with none of the certainty, simplicity and transparency of an explicit, formal price cap. What excess of suppliers' deemed rates over comparable rates qualifies as "much higher" is entirely unclear and the process envisaged for assessing this is enormously complicated. It will be burdensome for suppliers to try to prove compliance and for Ofgem to enforce this guidance. Moreover comparison with each supplier's non-deemed rates is meaningless if competition is not effective in the market generally. As a result this measure is likely to provide only limited protection for customers on deemed rate contracts.

Other actions

44. Other actions Ofgem has taken or is taking that do not directly address the features of the market that adversely affect competition are shown in the box below.

Other actions by Ofgem

- *Publishing on its website a best practice guide for security deposits.*[1]
- *Expanding the Standards of Conduct supply licence condition to apply to all non-domestic customers. This requires suppliers to treat all customers fairly.*[1] *For example, suppliers must make clear that prices may be subject to change and be clear regarding the circumstances in which this could happen.*[1]
- *Making representations to government following which it had raised the threshold at which business customers can access the energy ombudsman to seek redress for an unresolved dispute with an energy supplier.*[1]
- *Updating the Complaints Handling Standards to ensure suppliers put in place suitable complaints processes for small business customers.*[1]
- *Updating the redress rule on suppliers that work with TPIs to require suppliers to work only with TPIs that are members of a redress scheme.*[1]
- *Introducing a new supply licence rule for non-domestic suppliers to signpost the ability of specified business customers to go to appointed consumer bodies for support.*[1]
- *Documents required to demonstrate a change of tenancy (CoT) or change of occupier (CoO): a working group was formed to develop proposals for a consistent set of documents to demonstrate a valid change of tenancy which would be submitted to Ofgem for consideration and approval.*[1]

Ofgem's consultation on standing charges (2023)

45. Ofgem also addressed non-domestic standing charges in the discussion paper that launched its call for input on standing charges in November 2023.[77] This reported:-

    (i) Non-domestic contracts are more bespoke than domestic contracts and the terms of the contract will often be tailored to the needs of the individual business customer.[78] This may suggest that tariffs continue to be individually negotiated.
    (ii) There is a considerable difference in both unit rates and standing charges in the non-domestic sector. (It says a wide range of contracts might be expected given "the diversity of customers and suppliers in the sector, and different demand profiles and needs of these customers".)[79]
    (iii) It noted in particular the large variation in standing charges in this sector, ranging from around £1 per day for smaller sites to over £1,000 per day for very large business sites.[80]
    (iv) In some cases there was not a specified standing charge as part of fixed contract terms but instead the customer paid 'pass through costs' – in other words the supplier charged the customer whatever the supplier is billed for the site, for example from the network.[81]
    (v) Standing charges for customers on deemed rates exceeded those for contracted rates. It noted this might be due to suppliers pricing in to the standing charge higher risk and costs to serve associated with deemed rate customers, for example bad debt.[82]
    (vi) Which cost elements are included in standing charges varied widely across suppliers and across deemed and contracted rates.[83]
    (vii) It repeated the finding of Ofgem's non-domestic market review (see paragraph 30 above) that many non-domestic customers and organisations representing non-domestic customers had told Ofgem they did not understand the reasons for large increases in their bills, especially standing charges.[84]

46. Along with the findings of Ofgem's market review (see section above) these comments indicate that the AEC and the features responsible for it identified by the CMA (see paragraphs 8-11 above) still apply.

47. Ofgem said it was not obvious its focus should be on standing charges as the heterodox nature of products meant it was not possible to judge value for money just by comparing standing charges.[85] This is true, but misses the point: if standing charges were fixed (which would be the effect of capping them) it would be possible to judge value for money just by comparing unit rates (see paragraphs 71-72 below).

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[77] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) https://www.ofgem.gov.uk/call-for-input/standing-charges-call-input
[78] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) Paragraph 6.4.
[79] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) Paragraph 6.5.
[80] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) Paragraph 6.8.
[81] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) Paragraph 6.8.
[82] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) Paragraph 6.7.
[83] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) Paragraph 6.9.
[84] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) Paragraph 6.10.
[85] *Discussion Paper Standing Charges: Call for Input* Ofgem (November 2023) Paragraph 6.11.

The case for a new market investigation reference: (1) the adverse effect on competition

48. In conducting its non-domestic market review Ofgem seemed to have been oblivious to the CMA's analysis of competition in its energy market investigation. It did not directly consider any of the features of the market that were found by the CMA to adversely affect competition, notably the barriers to customers accessing and assessing information, which hinder them in considering and/or selecting a new supplier offering a lower price. Thus, for example, it considered price transparency only in terms of the information in customers' own bills rather than information about alternative tariffs. Strikingly, it also looked at competition only in terms of the effect on customer service, not the level of prices.

49. Nonetheless its market review and consultation on standing charges revealed that the problems identified by the CMA persist.

50. The measures Ofgem has put in place will not rectify the features identified by the CMA as adversely affecting competition. For example, they will have only very limited effect on customers' understanding of how they are charged by their current supplier and do nothing to improve the information available about other suppliers' tariffs (see paragraph 35 above). They also don't offer protection against high prices other than for customers on deemed contracts and even that is likely to be very limited in its effectiveness (see paragraphs 40-42 above).

51. Ofgem's apparent lack of awareness of the CMA's energy market investigation and the fact that it did not itself construct any kind of framework to assess competition may explain why it did not conclude on whether a deeper market investigation is needed despite having mooted this (see paragraph 28 above).

52. A market investigation reference is called for in order to resolve the continuing competition problems given the substantial scale of the detriment from higher prices to non-domestic customers, especially micro-businesses.

53. This section assesses the features that the CMA previously found adversely affected competition, in so doing incorporating points from the CMA's analysis of the domestic markets, and their likely interaction. Given that assessment, the following section describes appropriate remedies, which the CMA appears not to have considered during its previous market investigation.

Features adversely affecting competition

<u>The homogeneity of gas and electricity</u>

54. The CMA identified this as a factor affecting non-domestic customers' engagement (see paragraph 11(a)(i) above). It explained in relation to domestic consumers that the fact that there was no quality differentiation of gas and electricity might reduce consumers' enthusiasm for, and interest in, engaging in the energy markets, leading to customer inertia. It said this led to limited awareness of and interest among consumers in their ability to switch energy supplier (see footnote 15 above).

55. However, it is very debatable whether this is likely to apply to non-domestic consumers, particularly micro-businesses, given their likely level of motivation, understanding of markets and focus on making profit. This makes it likely that the fact that there is essentially only one factor to consider in relation to tariffs (i.e. price) actually increases engagement. It makes it easier to understand the value for money of both their current and other tariffs.

Traditional meters and bills and the structure of tariffs

56. The other feature the CMA identified as adversely affecting engagement was the role of traditional meters and bills (see paragraph 11(a)(ii) above). It said they are complex in their own right[86] and might be leading to a lack of visibility of energy consumption for many microbusiness customers. This, in turn, could be confusing and unhelpful to them in understanding the relationship between the energy they consume and the amount they ultimately pay. This was one of the "many similarities between domestic and microbusiness[87] energy supply".[88]

57. Even though the CMA didn't cite it as one of the features affecting competition in the non-domestic markets, the structure of tariffs is likely to be another. The CMA identified this as a source of complexity in *domestic* customers shopping around and seeking to compare energy tariffs and suppliers. As it noted, this complexity had been one of the main rationales for Ofgem's introduction of the Retail Market Review reforms aimed at simplifying suppliers' tariff offerings in 2014.[89]

58. The CMA said an energy tariff with both a fixed and variable component (meaning the standing charge and unit rate) "is likely to be more difficult for a domestic consumer to understand than a tariff with just a variable component". It said that in the presence of complex tariff structures domestic customers' lack of understanding of their own energy consumption levels could add a further layer of complexity.[90]

59. The CMA concluded that the complex information provided in bills and the structure of tariffs combined to inhibit domestic customers' value-for-money assessments of available options.[91] These factors are likely to affect microbusinesses' ability to assess tariffs too, especially given the greater size of standing charges in non-domestic bills and tariffs and their variability, both over time and across tariffs (see below).

The effect of standing charges

60. Standing charges underlie not only the complex structure of tariffs (see paragraph 57 above) but also the complexity of bills, especially as they cause the relationship between the energy a customer consumes and the amount they pay to alter as their consumption changes.

61. Non-domestic customers' difficulty in comparing their current tariff with others is exacerbated by both changes in the standing charges in the tariff they are currently on and variation in standing charges across tariffs. Ofgem's non-domestic market review referred to many stakeholders reporting large increases to their bills, especially standing charges, and considerable variation in standing charges across suppliers (see paragraph 30 above).

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[86] CMA final report paragraph 16.53.
[87] The amount of energy microbusiness customers consume varies but some spend similar amounts to domestic customers. 24% reported spending less than £1,000 a year on electricity and 27% less than £1,000 a year on gas while the mean figure for domestic customers for electricity and gas combined was £1,276. (CMA final report paragraph 16.10.)
[88] CMA final report paragraph 16.8.
[89] CMA final report paragraphs 9.159, 9.164-9.165.
[90] CMA final report paragraph 9.165.
[91] This was particularly the case for customers that lacked the capability to search and consider options fully. (CMA final report paragraphs 9.188, 9.563(b)(i).)

62. This has worsened since the CMA conducted its inquiry because standing charges have increased in size generally:-

- The ineffectiveness of competition has led to suppliers raising prices, as the CMA found (see paragraphs 14-16 above), and they are liable to have increased standing charges in particular. These are effectively 'free money' to suppliers once their relevant costs are covered as they do not need to provide anything (i.e. gas or electricity) in return and raising the level of them does not directly diminish demand for their product.

  Indeed the fact that raising standing charges further diminishes consumers' understanding of their bills and ability to compare tariffs and hence the competitive constraint on suppliers' prices may itself lead suppliers to increase them rather than the unit rate.

- Ofgem has exacerbated this by changing how some network charges are levied so that suppliers now pay a fixed amount[92], which means they are liable to recover these costs through the standing charge. Ofgem has done this even though its own previous analysis and that of the CMA were clear that all (or almost all) network costs should be recovered through the unit rate[93]. These analyses were in respect of the supply to domestic consumers but the same issues arise in relation to supply to non-domestic customers and indeed Ofgem has added network costs to the level of standing charges in the price cap on domestic tariffs too.

63. The greater size and variability of standing charges in non-domestic tariffs now mean that the complexity of bills and tariffs are likely to affect microbusinesses' ability to assess tariffs much more than at the time of the CMA's inquiry.

Interaction between features adversely affecting competition

64. The CMA noted that the lack of price transparency contributed to non-domestic customers' lack of engagement (see paragraphs 12-13 above). It seems plausible that there are other interactions between features adversely affecting competition too:-

    A. As described above, traditional meters and complex bills compound the complex structure of tariffs as customers' lack of knowledge of their own energy consumption and the variation in standing charges over time and across tariffs make it difficult to

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[92] Ofgem explained that these ('residual network charges') are levied as a daily site charge whereas previously they were recovered through unit rates for distribution charges and through time-of-use charges on usage at certain peak times for transmission charges. Non-domestic customers are charged under a banded structure made up of fixed transmission and distribution residual charges, based on capacity or consumption at a site. Ofgem concluded "Therefore, non-domestic consumers will see larger daily fixed charges than previously." (Although it then contradicted that by saying it was not guaranteed these costs would be charged to the customer as standing charges.) (*Discussion Paper Standing Charges: Call for Input* Ofgem November 2023 paragraphs 6.2-6.3.)

[93] Ofgem had determined that the bulk of the charges incurred by suppliers for use of the transmission and distribution networks should be recovered through the unit rate as they varied with the amount of energy consumed. Just a small element of electricity distribution costs were to be included in the standing charge. (*The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem (https://www.ofgem.gov.uk/publications-and-updates/standardised-element-standard-tariffs-under-retail-marker-review) Appendix 1 paragraphs 1.7-1.11.)
The CMA went further. In setting the pre-payment meter (PPM) price cap for nil consumption at the average standing charge of the (then) Big Six energy firms' PPM tariffs it broke the standing charge down into its components. It stated that "the value of the price cap at nil consumption does not include, nor need to include, network costs since these are volume driven" (CMA final report footnote 59 p.962). It said that the network charging statements of the network companies defined 'use of system' charges to be nil at nil consumption (CMA final report paragraph 14.144).

assess the value for money of alternative tariffs (including the one they are currently on).

B. Consumers' limited engagement and difficulty assessing tariffs confer market power on suppliers. Suppliers exploit this market power vis-à-vis their customers by negotiating prices individually. This enables them to utilise their greater knowledge and understanding of the market relative to their customers.

C. Suppliers might wish to make lower prices known in order to attract customers of other suppliers (for example, by publishing them) but (i) they could then be accessed and cited by existing customers in negotiations (ii) just as each supplier's own customers are less likely to switch away each supplier is also less likely to be able to attract other suppliers' customers.

D. Thus all customers' difficulty assessing tariffs leads suppliers to restrict price transparency. This further augments suppliers' market power vis-a-vis their existing consumers.

E. Note that suppliers with relatively few customers, including entrants to the market, would be less concerned about existing customers accessing information about lower prices ((i) in C. above). However, entry to the markets is impeded because these are mature markets (customers are largely contracted to suppliers) so any entrant must win customers almost entirely from other suppliers and consumers' difficulty assessing other suppliers' offerings makes it difficult for entrants to gain a critical mass of customers. (Indeed the CMA reported that the supply of both gas and electricity to microbusinesses was moderately concentrated.[94]) This barrier to entry and expansion further accentuates suppliers' market power.

F. Consumers' lack of understanding of their own bills and energy consumption, their difficulty comparing tariffs and suppliers' lack of transparency about their best available offers lead to the involvement in the market of TPIs.

G. However, TPIs' commission payments in turn exacerbate the complexity of bills and tariff offerings (notwithstanding Ofgem extending its rule requiring clarity of TPI service fees in contracts from microbusiness customers to all non-domestic customers). This further reduces customers' engagement and ability to assess tariffs.

H. TPIs (i.e. offline brokers) also inhibit the development of (online) PCWs as consumers are liable to think there is already someone they can engage with to help them get a good deal. This is notwithstanding their concerns about TPIs as they may have doubts about PCWs' commission rates and relationships with suppliers too.

65. Thus suppliers' market power and high prices derive from consumers' difficulties understanding their bills and level of consumption and assessing tariffs, which result in large part from the size and variability of standing charges.

<u>The CMA's previous price transparency remedy</u>

66. As described above, consumers' difficulty assessing tariffs means that suppliers' incentive is to exploit their market power vis-à-vis their customers by agreeing (high) prices in one to one negotiations rather than to make (lower) prices known in order to compete for other customers. This is likely to explain the apparent ineffectiveness of the CMA's remedy requiring suppliers to publish prices (see paragraphs 19-20 above).

[94] CMA final report paragraphs 16.30-16.31.

Suppliers' justifications for individual pricing and the non-emergence of PCWs

67. Large and variable standing charges also have a particular role in explaining suppliers' justification of:-

    a. Individual pricing

       Standing charges would be expected to vary between customers partly because they reflect metering costs. These vary according to the level of consumption as this affects the size of meter (particularly for gas). This is likely to underlie suppliers highlighting to the CMA the importance of tailored pricing due to the varied requirements of microbusinesses.[95]

       However, while the variation in meter sizes (and hence in metering costs and standing charges) means tariffs do have to reflect each customer's circumstances that doesn't mean they have to be tailored to the individual consumer (let alone individually negotiated) as there are only a limited number of meter sizes.

    b. The non-emergence of PCWs

       The CMA said the most common reason it heard for the difficulty of developing PCWs was the complexity of SME markets compared with the domestic markets. It also reported some parties saying that the complexity of customer demand and preferences and the variety of products on the market had resulted in PCWs struggling to establish themselves.[96]

       However, given the homogeneity of gas and electricity this 'complexity' and 'variety' is likely to relate mainly to variation in meter sizes and, to a lesser extent, consumption levels. It would be feasible for PCWs to have a role if standing charges were fixed or capped.

Difficulties securing energy contracts

68. Ofgem's non-domestic market review found that many customers struggled to secure any energy contracts (see paragraph 30 above). This is consistent with suppliers not striving to attract new customers. A prospective customer's expected demand would have to be *really* low for it not to be worth adding them to their systems and contacting a meter provider to take a reading. It seems likely that suppliers are simply more focused on managing their current customers to maximise profit from them.

69. Ofgem said that where there were offers to contract to supply energy, stakeholders reported suppliers making unreasonable requests for security deposits, up-front payments or other obligations in order to secure a contract (see paragraph 30 above). Smart meters can be converted to pre-payment meters which would avoid any concerns suppliers might have about new customers not paying for energy they consume so it is notable that suppliers appear not to do this.

70. Similarly, the CMA found that higher costs such as bad debt contributed to higher deemed rates (paragraph 11(c)) and Ofgem also lists higher risks and costs associated with deemed rate customers as a possible justification for them being charged more. These risks and costs could be due, for example, to bad debt, risk of non-payment, poor credit or not having had any contact with a customer in new premises (see the box at paragraph 39 above). Again, smart pre-payment meters would avoid the need for this.

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[95] CMA final report paragraph 16.74.
[96] CMA final report paragraphs 16.71, 16.78.

The case for a new market investigation reference: (2) potential remedies

1. A cap on the standing charge

71. The previous section showed that suppliers' market power and high prices derive from consumers' difficulty understanding their bills and level of consumption and assessing tariffs, which result in large part from the size and variability of standing charges. This section shows that an MIR is called for because an appropriate remedy is available.

72. A cap on just the standing charge would simplify bills and make it much easier for customers to compare tariffs as they would only need to know the unit rate to do that. This is because suppliers would invariably set their standing charges at the level of the cap because if they set it below that they would be foregoing revenue for which they didn't have to provide anything in return. (NB It would be necessary to supplement such a cap with a ban on suppliers charging a higher unit rate for the first units consumed as a *de facto* addition to the standing charge.)

73. This is particularly the case because the cap would be set substantially below the current level of standing charges, which would itself make it much easier for customers not only to compare tariffs but also to understand their own bills. (See under 'Setting the level of a cap on the standing charge' below.)

74. A cap on just the standing charge would thus strengthen competition by eliminating the factors that currently underlie the reduced competitive constraint on suppliers. It would avoid the drawback of price caps generally, and of a price cap on the total bill (i.e. the standing charge and the unit rate), that they reduce the scope for competition by reducing the gain to consumers from switching supplier and/or the attractiveness to suppliers of customers protected by a cap[97].

75. The CMA decided against a price cap on the total bill to protect microbusinesses partly because the heterogeneity of the microbusiness segment and the variation in consumption levels among microbusinesses would significantly increase the complexity of implementing, monitoring and enforcing this and its associated costs to suppliers (see paragraph 25 above).

76. That objection doesn't apply to a cap on just the standing charge, which the CMA appears not to have considered as a potential remedy. In fact it would be substantially simpler to set a cap on just the standing charge than a cap on both the standing charge and unit rate, as explained below.

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[97] It is recognised that price caps are liable to reduce competition. They can have a number of unintended adverse consequences, including:-

- Reduced customer engagement as price caps reduce the gain from switching supplier (CMA final report paragraphs 14.400-14.404). Both the CMA and Ofgem produced research showing that the level of switching depends on the savings on offer from doing so (CMA final report Appendix 9.1 Table 12 and paragraph 120 p.38 and *Consumer engagement in the energy market since the Retail Market Review – 2016 Survey Findings (Report prepared for Ofgem)* August 2016 https://www.ofgem.gov.uk/publications-and-updates/consumer-engagement-energy-market-retail-market-review-2016-survey-findings p.71.)
- Reduced competition between suppliers to attract customers who are protected by the cap, with a risk that the price cap forms a focal point to which suppliers raise their cheaper tariffs (CMA final report paragraphs 14.405-14.413). This could further reduce the savings that can be achieved by switching.

This means many customers on good deals are liable to see their bills increase following the introduction of a cap.

Setting the level of a cap on the standing charge

77. The efficient level of a cap on the standing charge depends on which elements of the costs incurred by suppliers should be recovered through it. This essentially depends on whether they are incremental costs of serving customers or, alternatively, related to the amount of energy consumed, in which case they should be recouped through the unit rate instead.

78. Ofgem and the CMA had both previously determined that almost all (if not all) network costs should be recovered through the unit rate rather than the standing charge as they varied with the amount of energy consumed:-

- In 2012 Ofgem considered which cost elements might be included in a fixed standing charge as part of its Retail Market Review reforms aimed at simplifying domestic tariffs. It assessed costs incurred by suppliers according to whether they varied with energy consumption. It found that the bulk of network costs did (all gas distribution and transmission costs, all electricity transmission costs and most electricity distribution costs) so should be recovered through the unit rate. Just a small element of electricity distribution costs was to be included in the standing charge.

- In its Energy Market Investigation the CMA concluded that the standing charge in a price cap should not include any network costs as they were volume driven (see footnote 121 below).

79. Ofgem's analysis and the CMA's views are set out in Annexe 2. These related to supply to domestic customers but the same issues generally apply with respect to non-domestic customers and, indeed, some micro-business customers have the same consumption levels and meter sizes as domestic customers (see footnote 87 above).

80. Ofgem consulted on whether to adopt a narrow or wide definition of a standardised standing charge. It said that under a 'narrow' definition it would include only the small fraction of network costs referred to above (estimated at £13 p.a.). Under a 'wide' definition the standing charge would also include:-

(i) Some costs of government policies aimed at tackling fuel poverty and/or carbon emissions. However, these costs should not be recovered through the non-domestic standing charge as these policies don't apply to non-domestic suppliers. Non-domestic users instead pay the Climate Change Levy on the gas and electricity they consume.

(ii) Metering costs. Ofgem cited £38 p.a. for this but it is likely to have been an over-estimate (see paragraph 6(iii) of Annexe 2). Moreover these costs would be reduced by a parallel MIR to address competition problems in metering markets (see below).

(iii) Other fixed costs of suppliers such as billing, bad debt and costs of depreciation and amortisation. Ofgem had allowed £40 p.a. for these but its procedure for estimating this was entirely flawed so this was likely to have been a significant over-estimate (see paragraph 6(iv) of Annexe 2).

As the CMA noted[98], bad debt is a more substantial issue for suppliers in the SME than domestic markets due to the risk of businesses ceasing trading. This was particularly the case since some customers would be supplied without the supplier having any details of the customer or payment arrangements (on 'deemed' tariffs).

[98] CMA final report paragraph 16.18.

However, the possibility of converting smart meters to pre-payment mode appears to offer a way of resolving this issue (see paragraphs 68 above and 87-89 below). In any case bad debt would be mainly attributable to charges for energy consumed, especially following an effective cap on the standing charge.

81. The appropriate level of the dual fuel standing charge for domestic consumers when the domestic price cap was introduced was of the order of £50-60 p.a. (adjusted for inflation, that is approx. £75 p.a. now). This is substantially lower than the standing charges currently faced by non-domestic customers with similar levels of consumption and meter sizes to domestic customers. Ofgem said standing charges ranged upwards from around £1 per day or £365 p.a. (see paragraph 44(iii) above).

82. Moreover the few categories of costs that should be recouped through the standing charge can be estimated much more accurately and transparently than suppliers' other costs. This means it would not be necessary to add supplementary amounts to mitigate variation in costs or uncertainty as to the efficient level, as was done with the cap on default tariffs for domestic consumers.[99]

83. Indeed while developing its plans to *fix* the standing charge (see paragraph 77 above) Ofgem had said the standing charge would be fixed by incorporating a schedule of standing charges into licences, with an automatic adjuster for subsequent years. Ofgem said that it would be possible to estimate the level of future costs with a reasonable degree of accuracy and that this would provide some certainty to suppliers about the future level of the standing charge.[100]

84. The standing charge cap would need to be specified for different meter sizes so standing charges would still vary between groups of customers but would effectively be fixed for each customer.

85. It would be important that the CMA specifies how the cap is to be calculated in order to ensure the benefits of this remedy. When Ofgem introduced the default tariff cap for domestic customers it actually set standing charges at the prevailing market level even though it was known that default tariffs were excessive (that was why the cap was being introduced). It has since substantially increased standing charges by including not only a substantial portion of network costs (see paragraph 61 above) but also the costs of paying suppliers to take on the customers of failed suppliers[101].

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[99] Thus the cap on default tariffs for domestic consumers set by Ofgem includes:-

- An allowance to allow for suppliers that have higher operating costs because they have a customer base that is more expensive to serve
- An allowance to allow for uncertainty in wholesale costs due, for example, to changes in demand volumes (such as caused by extreme weather)
- 'Headroom' added to the estimated benchmark level of costs to capture the residual risk and uncertainty faced by an efficient supplier that was not already captured in the assessment of costs.

These costs increased the level of the default tariff cap and reduced savings for all consumers (by £39 p.a. when the cap was introduced in 2019).

[100] *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem (https://www.ofgem.gov.uk/publications-and-updates/standardised-element-standard-tariffs-under-retail-marker-review). Paragraphs 2.26-2.29.

[101] Ofgem's Supplier of Last Resort process.

Previous initiatives to simplify tariffs

86. Both Ofgem and the CMA had previously sought to simplify *domestic* tariffs to make it easier for customers to understand and compare those on offer and thereby enhance the competitive constraint provided by customer switching. However, neither had proposed capping the standing charge:-

- Ofgem's Retail Market Review reforms of 2014 had banned complex tariffs and limited suppliers to offering four tariffs but the CMA recommended revoking these measures[102] as it thought they made it unlikely that suppliers would offer tariffs with no standing charge or a low one for low volume users[103].

- In developing its reforms Ofgem had considered *fixing* the stranding charge[104]. However, it decided against doing this apparently because respondents to its consultation expressed concern that this would prevent suppliers reflecting their fixed costs in the standing charge and offering tariffs with low or zero standing charges.[105]

- The CMA had considered requiring all suppliers to structure all tariffs as a single rate (apparently *eliminating* the standing charge) to make it easier for customers to compare tariffs but decided against this because it might restrict suppliers' competitive offerings.[106]

Note that none of the objections to these apply to a cap on the standing charge.

Effect of a standing charge cap on carbon emissions and security of supply

87. Capping the standing charge at the efficient level of costs would lead to some costs that have been included in it (such as network costs) being recovered through the unit rate instead. That would reduce energy demand, which would lower carbon emissions, improve the U.K.'s energy security and reduce the investment needed in generation and network capacity.

2. Ofgem publishing regular guidance on the competitive level of the unit rate

88. The CMA would set out the methodology by which Ofgem would do this. It would be similar to Ofgem's price cap for domestic consumers but would just be to help business customers in their negotiations with suppliers by informing them of the level of unit rate they could expect to achieve.

3. Eliminating obstacles to smart meters being installed and converted to pre-payment meters

89. In the course of a market investigation the CMA would look at the extent of the roll-out of smart meters and whether this had improved engagement as it expected it to (see paragraph 26 above). It would also be able to investigate whether there are any obstacles to smart meters being installed and converted to pre-payment meters for non-domestic customers as they can be for domestic customers. This would overcome many

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[102] CMA final report paragraphs 12.380, 12.382.
[103] CMA final report paragraph 9.509(c).
[104] *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem (https://www.ofgem.gov.uk/publications-and-updates/standardised-element-standard-tariffs-under-retail-marker-review) p.1.
[105] *The Retail Market Review – Updated domestic proposals* (October 2012) Ofgem. Paragraph 3.11.
[106] CMA final report paragraph 12.381.

of the risks to suppliers of taking on new customers and hence avoid the need for security deposits, up-front payments and higher ongoing payments. In doing so it would address the problem that a number of customers (those perceived as riskier, such as independent pubs) struggle to secure any energy contract at all.

90. Note that there is no reason why a standing charge cap should be any higher where smart meters are converted to pre-payment mode:-

- In 2014 Ofgem published the conclusions of a review of suppliers' costs[107] and said that while the costs of serving (domestic) prepayment customers were generally higher than for direct debit customers[108] they would be reduced by smart meters. Thus, for example, smart meters' ability to operate in prepayment mode removed the need to install and maintain a specialised prepayment meter for customers paying in this way.

- The CMA went further during its energy market investigation when it analysed the costs to suppliers associated with serving customers using different payment methods. It said that it expected that the higher cost of serving prepayment customers (relative to direct debit customers)[109] would be "*substantially eliminated* [our emphasis] as a result of the roll-out of smart meters"[110].[111]

91. Prepayment customers may actually be cheaper to serve than customers using other payment methods given that they pay in advance and cannot incur debt except in certain limited circumstances and then just for small amounts.[112]

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[107] *Price differences between payment methods - open letter* Ofgem 20 May 2014 pp.1,8.
[108] Ofgem found the costs of supplying prepayment customers were generally higher than for direct debit customers due to:
(i) the need to install a PPM at the customer's premises, which is more expensive to buy and maintain than a credit meter;
(ii) prepayment relying on a bespoke payment infrastructure (NB Prepayment Meter Infrastructure Provision – PPMIP – is a system for reconciling back to the relevant energy supplier the advance payments made by prepayment customers at outlets such as corner shops and post offices);
(iii) issues specific to prepayment customers, such as problems topping up the meter, which mean they are more likely to call their supplier, resulting in higher costs to serve.
(*Price differences between payment methods - open letter* Ofgem 20 May 2014 p.4.)
[109] The CMA said the major indirect costs of serving prepayment customers differed from those of serving direct debit customers and were:
(i) the cost of metering: prepayment meters are more costly than credit meters as they have additional functionality;
(ii) the cost of collecting payment: this consists of the PPMIP (which provides management information and generally acts as a conduit for data, processing it for suppliers and also providing services such as replacement of the card keys prepayment customers use to add credit to their meters) and the actual collection of cash via the National Service Infrastructure Providers (NSPs) – Paypoint, Post Office and Payzone – which provide the infrastructure that deals with the payment.
CMA final report Appendix 9.8 paragraphs 30-32.
[110] CMA final report Appendix 9.8 paragraphs 2-3 (similarly paragraph125).
[111] There would then be no, or negligible, differential costs of metering: the existing costs of PPMIP would disappear and the services of payment providers would not be needed as prepayment meter customers could top up by phone. (CMA final report Appendix 9.8 paragraph 125.)
[112] CMA final report Appendix 9.8 paragraphs 33, 60, 65-66,117-118.

Annexe 1: Non-domestic tariff types

(a) Tariffs with fixed prices:-

(i) Fixed-term contracts. These have fixed prices for the whole contract period. They are offered to either new customers ('acquisition fixed term contracts') or existing customers at the end of the fixed-term period ('retention fixed-term contacts). Typically they are offered for one to four years and are generally the cheapest option. Most customers are on these contracts. Unlike domestic customers, non-domestic customers are generally unable to leave during a fixed-term contract.

(ii) Auto-rollover contracts. When a fixed-term contract ends it may automatically be followed by an extension of the existing fixed-term contract or a new fixed-term contract (if the customer has not terminated the contract or agreed to a new fixed-term period). This is often at a different price to the original contract. There is no exit clause.

The biggest suppliers have replaced auto-rollover contracts with fixed-term contracts which a customer can leave after giving notice ('notice products'). (NB The CMA used the term 'replacement products' to refer to the broad set of tariff types that suppliers now use in place of auto-rollover contracts, i.e. 'notice' and 'evergreen' – see below.)

(b) Tariffs with variable prices:-

(i) Evergreen contracts (also known as 'tariff' or 'variable' products). These have no termination date and the prices are variable (changed periodically). Customers can give notice at any time (with no termination fee after giving notice).[113]

(ii) Deemed tariffs. These apply to customers that consume energy but have not signed up to a contract. May arise in two instances:

- when a non-domestic customer moves into new premises and starts to consume energy without a contract with a supplier
- when a fixed-term contract is terminated (other than where a customer becomes out of contract (OoC) – see below) but the supplier continues to supply the customer. This can arise if the original contract does not expressly say what will happen after termination and the existing customer continues to consume energy at the premises. A contract is deemed to exist and a customer will remain on this tariff unless it takes action to switch, with price changes being applied automatically.

(iii) Out of contract (OoC). Customers that have terminated their contracts but not yet switched to a new supplier. Customers are defaulted to this tariff type after termination and will remain on it unless they take action to switch, with price changes being applied automatically.

NB All tariff types other than fixed-term contracts are default tariffs: customers did not arrive on them as a result of an active decision. Prices are generally higher on these tariffs.[114]

[113] CMA final report paragraph 16.91.

Annexe 2: The efficient level of the standing charge

1. The efficient level of the standing charge depends on which elements of the costs incurred by suppliers should be recovered through it. This essentially depends on whether they are incremental costs of serving customers or, rather, related to the amount of energy consumed, in which case they should be recouped through the unit rate instead.

Cost elements of the standing charge

2. In 2012 Ofgem considered which cost elements might be included in a fixed standing charge in all domestic tariffs as part of its Retail Market Review reforms aimed at simplifying tariffs[115]. It assessed costs incurred by suppliers according to whether they varied with energy consumption.

3. It also consulted on whether to adopt a narrow or wide definition of a standardised standing charge. Although ultimately it did not conclude on that as it decided against fixing the standing charge because of opposition from respondents to its consultation, presumably energy firms[116].

4. It estimated those costs that might be included under the widest definition of the standing charge[117] as shown in the following table[118]:-

TABLE 1
Ofgem's estimate of costs to be included in the standing charge

		Illustrative annual cost for average consumer (£)	Recovered through	
			standing charge	unit rate
Network costs:	Gas transmission	6	X	✓
	Gas distribution	122	X	✓
	Electricity transmission	19	X	✓
	Electricity distribution	81	✓(£13)[d]	✓(£68)
Policy costs:	Energy Co. Obligation*	29 (gas), 29 (elec)	✓	X
	Warm Home Discount*	7 (gas), 7 (elec)	✓	X
Metering costs*		23 (gas), 15 (elec) [m]	✓	X
Other supplier fixed costs*		25 (gas), 25 (elec)	✓	X

[d] The Distribution Use of System (DUoS) fixed charge
* Not included under a narrow definition of the standing charge
[m] Metering costs estimates were based on traditional meters, not smart meters
[d] The Distribution Use of System (DUoS) fixed charge
Source: *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem (Table 2.1 p.11).

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[114] CMA final report paragraph 16.36.
[115] *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem (https://www.ofgem.gov.uk/publications-and-updates/standardised-element-standard-tariffs-under-retail-market-review).
[116] *The Retail Market Review – Updated domestic proposals* (October 2012) Ofgem paragraph 3.11.
[117] *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem paragraph 2.10 p.10.
[118] *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem table 2.1, p.11.

5. It said that under a 'narrow' definition the standing charge would include only the element of network costs included under the widest definition, as per the table above[119].

6. Considering the possible elements of a fixed standing charge:-

   i) Network (transmission and distribution) costs

   Ofgem determined that the bulk of the charges incurred by suppliers for use of the transmission and distribution networks should be recovered through the unit rate as they varied with the amount of energy consumed. Just a small element of electricity distribution costs was to be included in the standing charge[120].

   The CMA's Energy Market Investigation went further. In setting the PPM price cap for nil consumption at the average standing charge of the Big Six energy firms' PPM tariffs it broke the standing charge down into its components. It stated that "the value of the price cap at nil consumption does not include, nor need to include, network costs since these are volume driven"[121]. It said that the network charging statements of the network companies defined 'use of system' charges to be nil at nil consumption[122].

   Thus it has been acknowledged that almost all (if not all) network costs should be recovered through the unit rate.

   ii) Costs of government policies aimed at tackling fuel poverty and/or reducing carbon emissions

   The above table includes only the Energy Company Obligation (ECO)[123] and Warm Home Discount[124]. However, non-domestic suppliers are exempt from these. (In any case Ofgem confirmed that the costs that suppliers incur under ECO, feed-in tariffs[125] and the Renewables Obligation[126] as well as Contracts for Difference, the Capacity Market and AAHEDC[127] depend on the amount of energy supplied rather than the number of customers served. Thus, they would efficiently be recovered through the

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[119] *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem paragraphs 1.13, 2.7-2.8, Appendix 1 paragraph 1.2.
[120] *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem Appendix 1 paragraphs 1.7-1.11.
[121] *Energy Market Investigation Final report* June 2016 CMA footnote 59 p.962.
[122] *Energy Market Investigation Final report* June 2016 CMA paragraph 14.144.
[123] ECO places an obligation on suppliers to install energy efficiency measures according to their overall share of the *domestic* gas and electricity market.
[124] The Warm Home Discount requires larger suppliers (more than 50,000 *domestic* customers) to provide bill support, primarily through bill rebates, to customers who are in or at risk of fuel poverty.
[125] Feed-in tariffs encourage small-scale, low carbon generation but have largely closed to new applicants. (*Energy Market Investigation Final report* June 2016 CMA paragraphs 3, 21-23, 26-28 of Appendix 8.1.) Suppliers (with at least 250,000 domestic customers) are required to make payments to individuals and organisations for generating and exporting low carbon electricity. The costs of the FIT scheme are spread across all electricity suppliers according to each supplier's share of the electricity market (seemingly including supply to non-domestic customers) in terms of the amount of electricity supplied (taking into account FIT payments they have already made). (*Feed-in Tariff Annual Report 2015-16* (Dec. 2016) Ofgem p.5 and *Feed-in Tariff: Guidance for Licensed Electricity Suppliers (Version 8.1)* (May 2016) Ofgem chapter 9.)
[126] This requires suppliers to source a specified proportion of their electricity from eligible renewable sources or pay a penalty.
[127] Assistance for Areas with High Electricity Distribution Costs

unit rate rather than the standing charge. It said that it would expect to design the default tariff cap for domestic customers to reflect this.[128])

Instead, non-domestic users pay the Climate Change Levy, a tax on energy delivered. The current rate is 0.775p/kWh for both electricity and gas. Thus it is inappropriate for any policy costs to be recovered through the non-domestic standing charge.

iii) Costs of meter provision

The costs incurred in providing meters clearly relate to serving customers so are appropriately recovered through the standing charge. The cost suppliers incur for providing domestic gas meters is regulated by a price cap, which was set at £15.63 p.a. for 2016-17[129]. Most non-domestic customers would have larger meters which are more expensive to provide than domestic-size meters although a significant minority of microbusinesses have similar levels of consumption so would have domestic-size meters.

Electricity meters appear to be cheaper to provide: they are less sophisticated than gas meters, which involve a hazardous substance, and the CMA allowed less for electricity meters when it set the pre-payment meter price cap[130].

Suppliers also needed to pay for the smart meter roll-out. The cost of this was estimated at £1.50 per domestic customer per year[131].

iv) Other fixed costs

Ofgem calculated these simply by subtracting the above costs from the typical standing charge paid by domestic customers[132]. Given the lack of constraint on the amounts suppliers levied as standing charges due to the lack of effective competition this estimate was not meaningful and was liable to have been a significant overestimate.

Ofgem has said separately that suppliers' other operating costs include the costs associated with billing and bad debt and costs associated with depreciation and amortisation[133]. It is not possible in this short paper to quantify all such factors and assess what proportion of them might be attributable to the standing charge. However, billing costs presumably would be, while bad debt might be mainly attributable to charges for energy consumed, especially following an effective cap on the standing charge, as charges for energy supplied account for the bulk of energy bills.

Meter reading costs form another category of costs that are reasonably attributable to the standing charge. However, the roll-out of smart meters will reduce this and the costs of serving customers generally[134].

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[128] *Working paper #4: Treatment of environmental and social obligation costs under the default tariff cap* (April 2018) Ofgem paragraph 1.6, Table 2, paragraphs 4.8-4.9.
[129] *Metering charges from 1 April 2016* National Grid p.12 (https://www.nationalgas.com/document/82076/download).
[130] *Energy Market Investigation Final report* June 2016 CMA paragraph 14.122.
[131] *Energy Market Investigation Final report* June 2016 CMA paragraph 14.238.
[132] *The Standardised Element of Standard Tariffs under the Retail Market Review* (February 2012) Ofgem Appendix 1 paragraph 1.47.
[133] *Retail Energy Markets in 2016* Ofgem p.31.
[134] *Energy Market Investigation Final report* June 2016 CMA paragraph 14.119 and paragraph 3 of Appendix 9.8.

Ofgem said suppliers earn a margin on their sales of energy too[135]. It is not appropriate for suppliers to earn a margin on the standing charge given that this merely enables a customer to receive supply of energy and does not itself have an intrinsic value to consumers.

7. Thus the costs of providing meters appear to be the main category of costs that do not vary with the level of consumption so are justifiably recouped through the standing charge. Other elements may be (possibly) a small element of electricity distribution costs; meter reading costs; billing costs; and some fraction of other overheads/other fixed costs.

8. Of the costs in Table 1 above, the only ones that were rightfully included in the standing charge in domestic tariffs were:-

   a) (possibly) electricity distribution costs (£13)
   b) some proportion of the metering costs of £38, although note that this may be an overestimate given the amounts cited in (iii) above, and
   c) some fraction of the other fixed costs of £50.

   This suggests that the appropriate level of the dual fuel standing charge for non-prepayment meter domestic customers prior to the imposition of the default tariff cap in 2019 was of the order of £50-60 p.a. (excl. VAT). The corresponding figure now (adjusting for inflation) is likely to be of the order of £75 p.a., which is substantially less than the standing charges typically levied on microbusiness customers with similar levels of consumption to domestic customers.

[135] *Retail Energy Markets in 2016* Ofgem p.31.