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**22 July 2022**

### **Open letter: review of how supplier failure costs are recovered**

We welcome the opportunity to comment on the review of how supplier failure costs are recovered. Responses to the questions from the open letter are below.

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

The potential impact on energy bills for winter is relatively limited, as the consultation is relevant only to the element of SoLR<sup>1</sup> costs that are being recovered through electricity charges. This equates to a reduction in fixed charges of around £17 per household in total, offset by the increase in volumetric charges. Whilst we agree that the level of SoLR costs themselves are extraordinary, we are concerned that Ofgem and industry resource and attention could be taken away from initiatives that deliver more significant and lasting benefits for consumers.

Recovering SoLR costs involves difficult trade-offs with judgement over whether fixed or volumetric charges are fairer. We believe that the fairest, and more progressive, way to recover SoLR costs is through general taxation. We recognise that this is not within the scope of this consultation, but believe future costs relating to supplier failure, such as arising from Special Administration, should be recovered in this way.

*b) How do you consider we should manage trade-offs between charging on a fixed charge basis vs. volumetric?*

Generally, it is in the interests of consumers for volumetric charges to reflect only those costs that vary with usage. If costs that are fixed in nature, such as SoLR costs, are included then the rewards for avoiding volumetric charges, for example by installing behind-the-meter generation, are too high. This leads to inefficient outcomes and higher costs for consumers overall. This was clearly established by

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<sup>1</sup> Supplier of Last Resort

Ofgem in the Targeted Charging Review where ensuring volumetric charges reflect only those costs that vary with usage was estimated to reduce costs for consumers by £300m pa.

Consumers that are able to install low carbon technologies to manage their consumption are more likely to be affluent households. The number of consumers able to be flexible in how they use electricity is expected to increase significantly, and needs to increase to deliver our net zero ambitions. Any contribution to fixed costs that is avoided or reduced will need to be recovered from other consumers, including those unable to invest in low carbon technologies. If this consultation results in a change in how SoLR costs are recovered, it should be made clear that this is not a precedent for other fixed costs.

So, the default position should be to only include costs that vary with usage within volumetric charges. Evidence should be required to move away from the default position.

We would also note that SOLR costs are already recovered via volumetric charges for gas. So, for dual-fuel customers, a balance between fixed and volumetric charges is already in place (without the issues about providing incentives to avoid volumetric charges as the opportunities to do so are more limited for gas).

We recognise that there is another cohort of customers who are low consuming and low income. The needs of this group of customers are better achieved through more targeted means. Citizens Advice is currently working with Public First and SMF on an energy price support review which is aimed at developing consensus around the longer term approach to tackling energy affordability. In the interim, the structure of the government's current support package, and particularly, the £400 rebate, will help support low consuming, low income households.

*c) Should SoLR costs be recovered by fixed charges, unit rate charges (i.e. volumetric), or some other method?*

Whilst we believe the default position should be that SoLR costs are not recovered by volumetric charges we recognise that the current extraordinary level of SoLR costs is likely to be temporary. This means the impact of inefficient outcomes will be limited and so recovering through volumetric charges on a time-limited basis should be considered.

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

Moving SoLR costs from fixed to volumetric charges will reduce costs for low consuming customers and increase costs for high consuming customers. If it can be established that vulnerable consumers are disproportionately represented within low consumers then moving to volumetric charges would be in vulnerable consumers' interests overall (although more support would be required for vulnerable consumers who are high users). We note that the evidence Ofgem has presented does not establish this at this stage.



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Our research<sup>2</sup> supports that there is some linkage between usage and vulnerability, but it is not particularly strong. Any interventions need to be properly targeted. Adjusting fixed charges reduces costs for all lower consuming customers whilst increasing costs for all higher consuming consumers, for example including those with health needs requiring electricity. The use of volumetric charging could disproportionately impact customers with protected characteristics. For example, disabled consumers may require high levels of energy use to keep their homes at a certain temperature, or to charge electric equipment such as wheelchairs. Disabled consumers already face higher living costs than non-disabled consumers. Mitigations should be put in place (e.g. increasing the value of WHD) if this is carried forward.

Removing SoLR costs from fixed charges, but not adding to volumetric charges, would clearly be in the interest of vulnerable consumers. If possible this could be targeted towards vulnerable customers, as a rebate towards the standing charge. This would require some SoLR costs to be funded through general taxation.

*e) If changes were deemed to be necessary, should that take place: i. On an enduring basis; or ii. On a time-limited basis? iii. And if so, why?*

Changes should be on a time-limited basis. As explained above, enduring arrangements may lead to inefficient outcomes for consumers.

*f) If changes were deemed to be necessary, would you rather that they: i. were implemented using standard industry processes, even if this takes longer; or ii. were implemented as soon as possible, even if this meant using nonstandard processes? iii. And if so, why?*

Any changes need to be implemented in time to be reflected in the October price cap to avoid the impact being limited further

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

The Energy Bills Support Scheme is applied on a £/household basis (i.e. not related to consumption). This means it provides more support, in terms of percentage of energy bill, to low consuming

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<https://www.citizensadvice.org.uk/about-us/our-work/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/understanding-high-and-low-electricity-usage/>

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vulnerable customers than high consuming vulnerable customers. This supports that clear evidence is required that vulnerable customers are disproportionately represented within low consuming households before any changes are made (and that further support would be required for the high consuming vulnerable customers who would be disadvantaged).

*h) Do you consider there to be any further impacts that need to be considered, for example on supplier, DNO or IDNO businesses, on the risks held by industry, investors or external parties, or on wider industry arrangements? i) Do you consider there are any unintended consequences associated with the potential recovery through fixed or volumetric charges or any alternative method you are proposing?*

We would also note the impact of moving SoLR costs from fixed to volumetric charges is relatively limited when compared to annual energy bills expected to be above £3000. Standing charges would reduce around £17 per household in total between October 2022 and March 2023, and potentially a smaller amount in the following year, all to be offset by the increase in volumetric charges. The change may still be worthwhile but care should be taken that Ofgem and industry resource and attention is not taken away from initiatives that could deliver more significant and lasting benefits for consumers.

Yours sincerely,

Andy Manning

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