



Independent Networks
Association

James Crump
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By email only to StandingCharges@ofgem.gov.uk

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Dear James

The Independent Network Association (INA) represents independent utility networks operating across electricity, gas and water in Great Britain. As an organisation, the INA has a diverse membership which brings significant cross-vector experience in delivering utility networks. This cross-utility experience has also provided us with experience of a range of regulators and pricing mechanisms. The INA welcomes the opportunity to respond to this call for input on standing charges in energy bills.

The INA's membership own and operate gas and electricity network through licensed business and these licensees charge energy shippers and suppliers for the use of these networks. In the case of electricity suppliers these include a fixed tariff component and, in the case of gas shippers, are largely fixed according to user capacity. INA members also provide water networks where charges are levied, primarily, to end consumers and where there is ordinarily also a fixed component of the charge.

We believe that it is important to recognise the nature of fixed charges in relation to the provision of networks and the extent to which these are being recovered from suppliers (and so customers) in a fair and reflective way. We have answered the first section, which are relevant to our members' experience as network operators, of Ofgem's questions in the appendix to this letter but have also set out what we believe to be the most relevant points below.

Ofgem's Targeted Charging Review (TCR) highlighted that the decision to move the residual element of network charging from the unit charge component to the fixed charge component would save consumers between £0.5bn and £1.6bn and that the benefits to the system would



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be even higher. It is important Ofgem consider, in this work, the benefits that removing harmful distortions from the recovery of the residual charge has brought. The justifications and rationale for Ofgem's decision in 2019 remain true today.

More broadly than the recovery of the residual charge, we believe that charges for operating distribution networks are largely fixed and so the recovery of such costs should be, at least to some extent, fixed. Ofgem represents the dichotomy between the types of costs recovered in network charging as between 'cost-reflective' and 'residual'. Although cost reflective is later also referred to as forward-looking we think that it is unhelpful to use these two terms interchangeably. Forward-looking charges are, inherently, designed to send a price signal which may not reflect the costs of the network but drive behaviour which reduces future costs. Our assertion is that a large proportion of network costs are fixed and that if the intention of part of the charge was to be cost reflective then it would logically follow that the these should be recovered by a fixed charge.

We recognise that there are a wider range of costs which are included in the standing charge that customers face, and we do not believe that we are able to comment on all of those costs. However, in respect of network costs, we believe that the argument for fixed charges being retained are clear and have already been made, in part, as part of Ofgem's TCR.

We note that in the foreword Ofgem assert that the way that they regulate has an impact on the way that suppliers need to recover costs and yet later in document (under the heading "There is no Ofgem Standing Charge") also suggest that there is no regulatory barrier to suppliers being able to deliver tariffs with zero fixed charges. We agree with the latter statement but understand suppliers' reticence to offer tariffs with no fixed charges which are only likely to be adopted by customers with low consumption who would stand to benefit from them (and therefore the supplier may not be able to recover their cost to serve that customers).

Ofgem have identified issues around fairness and the burden of charges falling disproportionately on those with the least ability to pay. We recognise that this is an issue that needs to be resolved and we think it's important that, in resolving that issue, the aims and intent of any solution are fully clear and that any cross-subsidy is explicit and recognised. We don't believe (and nor are Ofgem necessarily suggesting) that moving costs, network costs or otherwise, between fixed and unit recovery mechanisms which reduces reflectivity and ultimately increases costs in the long run for consumers is an appropriate solution. It is important that where there are policy and fairness considerations that these are drawn out so that those consumers who should benefit from them are able to benefit from them and



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there are no unintended consequences. This could be through the introduction of a social tariff which is subsidised by other users or through Government intervention which provides additional income to consumers to pay for the fixed charge.

Yours sincerely,

Nicola Pitts
Executive Director

Appendix 1 – Responses to questions

1. *What are the barriers to suppliers using the existing flexibility under the price cap.*

We do not have detailed experience in this area as independent network operators but we believe that suppliers' customers are only likely to take up this flexibility and opt for lower fixed rate tariffs (with higher unit rates) where it is economic for them to do so and they are lower energy users. This would leave suppliers with a shortfall in cost recovery as no high energy users would be, in effect, providing the subsidy to the lower energy users on the existing split.

2. *Why are suppliers not innovating on standing charges for tariffs nor covered by the price cap.*

As with our answer to question 1, we are unable to point to experience to answer this question but we believe that the reasons may be similar to those given above.

3. *What changes could Ofgem make to improve provision for lower standing charges under the cap.*

We do not have comments on this question

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

This question asks us to consider the fairness of customers paying a cost reflective price for access to service without defining the parameters of fairness. Arguably it is fair that customers should pay the costs that they bring to bear on the system and that any attempt to change or alter this is a cross-subsidy with winners and losers which cannot be easily defined through network charging. We also believe that it is likely to be considered fair and in the interests of customers for consumer behaviour to be appropriately incentivised to reduce future costs, which was one of the outcomes of the TCR. We note that the TCR only concluded within the last five years and the issues which were addressed in the TCR are not likely to have changed materially.

We find it difficult to argue that it is fair for customers with very low consumption to pay less for the service that they receive. Doing so, would inherently pass those costs onto other users in a non-reflective way. It is not true to say that customers with higher consumption necessarily have a greater ability to pay, and vice versa. Customers with high consumption for electric storage heaters, heating a home they cannot afford to better insulate, or medical equipment should not pay disproportionately more than the costs that they impose on the network by nature of the situation in which they find themselves, nor should second

homeowners or those with adequate capital resources to install PV and storage (include vehicle to grid) avoid paying.

We have argued in the body of our letter that network charges should be as least distortive and as cost reflective as possible and that any consideration for fairness in this context should relate to those criteria. Where there are questions of socio-economic fairness, which are valid questions, they should be considered separately, and deliberately by Ofgem or Government.

5. What are the reasons for regional variations in electricity standing charges

There are legitimate differences in regional standing charges which generally relate to the geography and topography of networks serving those customers as well as network configuration and security of supply. Some of these reasons will be borne out of the distribution network charges which are derived from the 500MW model and there are differences of interpretation in this model. There are also differences in the level of residual charges which are recovered by each regional DNO which could relate to how costs are stated in the forward-looking part of the charge compared to the historic costs which are recovered through the residual.

To some extent the variation could be mitigated through more transparency to ensure the consistent application, at distribution level, of the 500MW model. Whilst we cannot say that this is being applied differently in every case, the opaque nature of the model makes it difficult to assess how this is impacting different standing charges. This could also be supplemented by an updated model which is more cost reflective and minimises the amount of revenue which is recovered through the residual (i.e. fixed) charge. This may not necessarily result in lower fixed charges, but it would ensure that those charges are created and levied in a cost reflective (and therefore by many measures, fair) way.

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

Whilst we believe that other sectors can provide learnings to the retail energy market, we do not necessarily think that there is a single alternative which should act as a model to which the energy market should move. Ofgem have illustrated in their consultation that there are marked differences with the competitive environments in other utility sectors.

For example, in water there is no opportunity for domestic customers to be able to switch their retail offering and so there is little scope or room for innovation. Conversely in telecoms markets there has been a dynamic competitive market which includes the provision of a range of services and customer have sought price certainty (i.e. a standing charge) over variability according to usage.

These differences highlight the different responses from consumers when faced with different markets and show that one of the most important elements of managing the energy retail market is ensuring that there is adequate space for innovative tariffs and offerings to



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develop. We note that there is work underway in the electricity market-wide half-hourly settlement programme which may lead to more space to innovate.

One area which may be relevant when considering the UK energy market's retail offering is the development of a social energy tariff, similar to those offered by the water companies. One of the issues highlighted by the standing charge debate is the perceived unfairness from the disproportionate impact on those who are least able to pay. Whilst we don't think that it is in consumers' interests to reduce costs reflectively of tariffs as we think this likely adds costs to customers' bills in the long run, we do believe that clear, well-defined subsidies for those who require the most support are a policy and societal choice which could be learned from the water market. Where those societal choices are made, they should typically be a choice for Government and delivered separately to a price signal through a charge to customers.