



Northern Powergrid response to the Ofgem Standing Charges: Call for Input

KEY POINTS

- Network costs represent significant investment for the relevant network company, with a high level of fixed costs and long asset lives. The balance between volumetric (p/day) and fixed (p/day) charges better reflects this position since implementation of Ofgem's Targeted Charging Review ("TCR") Significant Code Review ("SCR").
- We agree that standing charges have a legitimate role to play in recovering fixed costs and ensuring cost-recovery to fund network investment.
- This is particularly pertinent in respect of the increased investment that is required to ensure the resilience of the existing networks and to meet the increasing demands of the government's net zero and energy security targets.
- To continue to support the low carbon energy transition, standing charges should primarily represent costs that (i) do not vary according to energy usage and, therefore, (ii) should not seek to influence customer behaviour. We do not believe that this simple principle is being achieved effectively.
- Ofgem should review how costs are allocated as part of the Distribution Use of System ("DUoS") SCR to ensure that cost-recovery better reflects the primary cost drivers.
- Whilst not being the end goal, more effective cost allocation should further benefit by reducing the quantum of the "residual" charges, which evidently remains a signal that customers seek to avoid (thus increasing charges for others).
- Underlying DUoS standing charges remain stable – the increase in recent years primarily reflects non-network costs (i.e. Supplier of Last Resort ("SoLR") cost-recovery), and the "residual" charges.
- Whilst it has increased, the DUoS standing charge remains a relatively small proportion of the retail bill. Cost-reflectivity should be improved, but DUoS standing charges are not the problem to be solved.
- DUoS standing charges should not discriminate between domestic customers. Targeted protection should continue to be driven by government policy via suppliers – who have a direct relationship with customers and greater visibility of usage and vulnerability indicators.

1. Executive Summary

Costs should be allocated based on their primary driver to avoid inefficient price signals.

1. Standing charges should primarily represent recovery of costs that do not vary according to energy usage. We do not believe that this simple principle is being achieved effectively.
2. The DUoS standing charge for domestic and most non-domestic customers is primarily determined by allocating notional costs based on long-standing (arguably arbitrary) assumptions (e.g. “standing charge factors”¹), plus:
 - The costs of service assets (e.g. LV service cables direct to a property); and
 - Via the “residual” charge by default.²
3. For the small minority of non-domestic customers, i.e. the largest non-domestic customers connected at the highest network voltages, the DUoS standing charge primarily reflects costs of sole use connection assets.
4. Where costs cannot, or should not, be influenced by user behaviour, they should be allocated such that they do not seek to influence that behaviour. Ofgem has indicated that – via the DUoS SCR – it will not review cost allocation in the near-term. We encourage Ofgem to revisit this view at the earliest opportunity.
5. Reform to DUoS charges should result in effective allocation of costs to different voltages and charge “types” (volumetric/capacity/standing), whilst also reducing the quantum of the “residual” charge. Reducing the materiality of “residual” charges would serve to mitigate the need for ongoing piecemeal changes to the DUoS charging methodology via open industry governance arrangements that seek to provide opportunities for more customers to avoid charges that should not incentivise behaviour.
6. The “residual” charge should not include costs that can be allocated to specific voltage levels, customer “types” or a specific charge “type”, before the need to reconcile and ensure cost-recovery of allowed revenue.

Underlying DUoS standing charges remain stable.

7. DUoS charges for all LV and HV customers³ have, on average, targeted the recovery of around £6.8bn p.a. between 2021/22 and 2025/26, of which around:
 - £2.9bn (ca.40%) is recovered via volumetric (p/kWh) charges;
 - £0.9bn (ca.15%) is recovered via capacity (p/kVA/day) charges; and
 - £3.0bn (ca.45%) is recovered via standing (p/day) charges.⁴
8. DUoS standing charges cover three distinct categories:
 - **“Cost-reflective”** (around £0.7bn (ca.25%) on average p.a.) – primarily reflecting costs at the voltage of supply plus service assets;
 - **“Residual”** (around £2.0bn (ca.65%) on average p.a.) – being the top-up amount to ensure cost-recovery; and

¹ Standing charge factors are used in the calculation of low voltage (“LV”) and high voltage (“HV”) DUoS charges to determine the proportion of unit costs to be allocated to capacity or fixed charges, rather than unit charges, for metered customers. These factors are specific to each “type” of customer and vary by voltage level.

² The “residual” charge in effect represents unallocated costs and a “top-up” to allowed revenue to ensure cost-recovery. The “residual charge” was moved from volumetric charges to the standing charge as a result of the TCR in order to disincentivise customers from responding to an inefficient price signal and thus avoid costs.

³ Accounting for around 97% of revenue from DUoS charges.

⁴ In addition, around £13m p.a. is recovered via reactive power (p/kVArh) charges.

- **“Fixed adders”** (around £0.3bn (ca.10%) on average p.a.) – being the recovery of pass-through SoLR costs and bad debt through DUoS charges.
- Most revenue from DUoS standing charges, therefore, relates to the “residual” charge, which was moved to a p/day recovery basis via the TCR effective from 1 April 2022.⁵
 - The “fixed adders” component is primarily driven by SoLR costs associated with supplier “failure” in Q4 2021, where DUoS charges recovered around £1.0bn in 2022/23 and are recovering a further £0.3bn in 2023/24 and reduces to around £0.1bn in 2024/25 and is expected to reduce further in future.⁶
 - DUoS revenue from the “cost-reflective” standing charge has remained relatively flat as shown in Figure 1. This is generally true for all elements of the DUoS charge other than the “residual” charge and the “fixed adders” components.

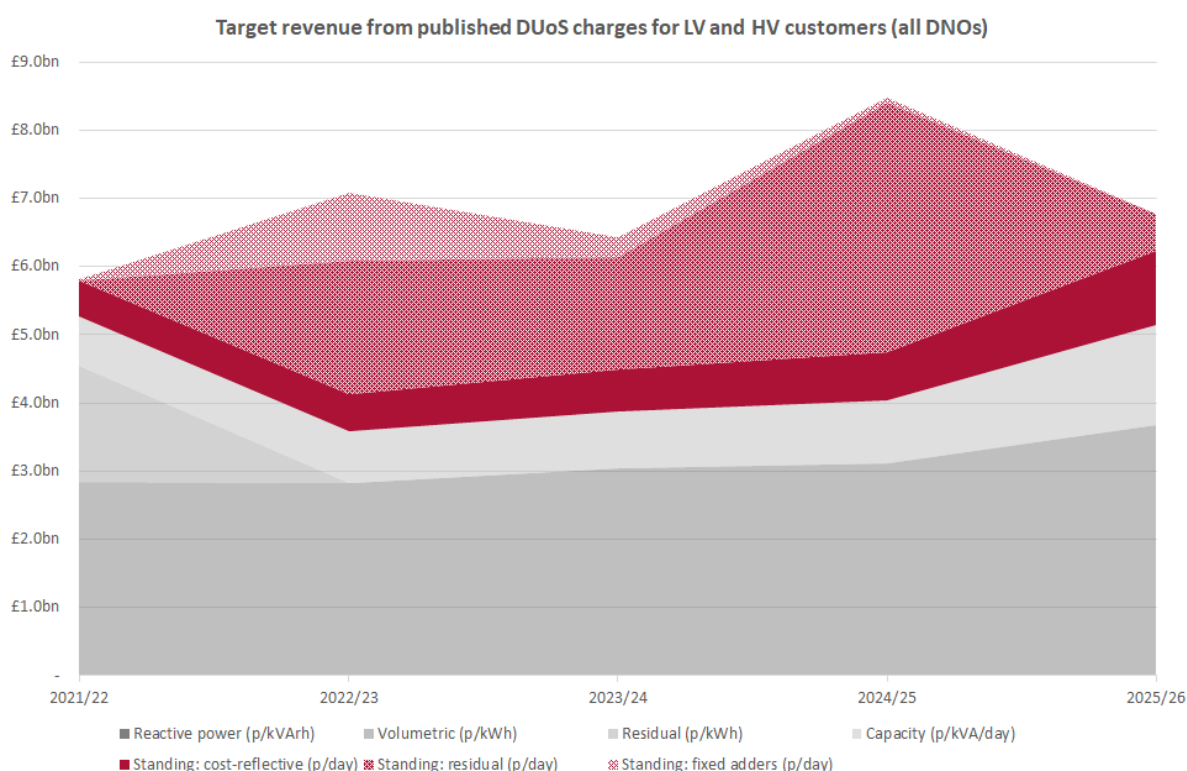


Figure 1: Annual revenue from DUoS charges by charge "type"

DUoS standing charges represent a low proportion of the retail standing charge.

- Ofgem states that a typical direct debit customer’s average annual standing charge has more than doubled from £86 to £186 between 2021 and 2023.
- The DUoS standing charge for a domestic customer in 2021/22 was on average around £17 p.a. (around 20% of the £86) and this increased by ca. £29 to ca. £46 in 2023/24; which was primarily driven by the TCR (i.e. moving how DUoS revenue is recovered as opposed to an underlying

⁵ Prior to 2022/23, the “residual” charge was recovered via volumetric charges (ca.£1.7bn in 2021/22). The “residual” charge recovers ca.£1.8bn on average p.a. but increased to ca.£3.6bn in 2024/25 due to increased allowed revenue, including the “correction” of under-recovery in both 2022/23 and 2023/24.

⁶ A net ca.£9m (gross ca.£22m) will impact 2025/26 (via the “correction” of 2024/25 over/under-recovery).

increase). This increased further by ca.£9 to ca.£55 (around 30% of the £186) due to the recovery of pass-through SoLR costs in 2023/24.⁷

14. The DUoS standing charge will increase by ca.£23 to ca.£78 in 2024/25 (via a higher residual charge), primarily driven by the recovery of prior year “under-recovery” due to unforeseeable higher inflation and will then reduce by ca.£37 to ca.£41 in 2025/26; primarily driven by lower residual charges.

Proportionally, the total DUoS standing charge currently better reflects the fixed nature of electricity network costs – whilst retaining a material volumetric price signal.

15. Prior to implementation of the TCR from 2022/23, DUoS standing charges accounted for around 20% of the DUoS charge paid by a typical domestic customer. It now accounts for, on average, roughly 50% with volumetric charges, as shown in Figure 2.
16. However, the cost-reflective DUoS standing charge component is generally less than half of the volumetric equivalent.

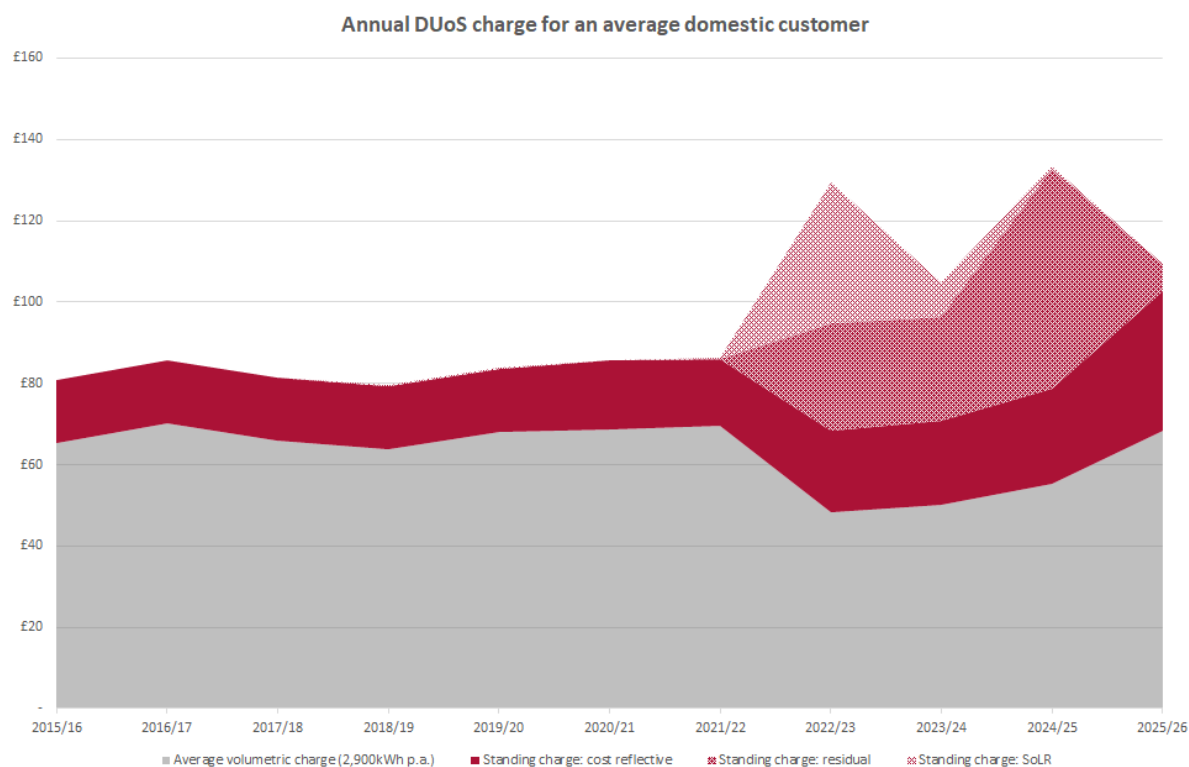


Figure 2: Average annual DUoS bill for a domestic customer

⁷ DUoS charges for 2023/24 were published in December 2021, and then republished in February 2023 to recover SoLR costs for suppliers.

2. Detailed responses to the questions

17. We have focussed our response within the context of DUoS charges to questions 4 and 5 only.

Q4. As a result of TCR and changes to the recovery of residual 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 gas and electricity networks. Is this fair? Should more be done to shield these customers from these costs?

18. The DUoS standing charge accounts for around 50% of the total DUoS charge for an average domestic customer, with the other 50% being volumetric charges.⁸ This is arguably not fully reflective of the fixed nature of electricity network costs, which are recovered over a long period.

19. DUoS standing charges should not discriminate between domestic customers based on electricity usage. Any such protection should be via targeted retail charges driven by government policy, where suppliers have greater visibility of vulnerable customers (e.g. those eligible for the Warm Home Discount) and disaggregated usage information.

20. Customers can move in and out of vulnerability and change usage over time, as well as move location, meaning network charges are not the appropriate vehicle to address such issues.

Q5. What are the reasons for regional variations in electricity standing charges?

21. Across the 14 Distribution Network Operators (“DNOs”), the average minimum cost-reflective DUoS standing charge since 2021/22 is ca.£11 per annum, with the average maximum equivalent being ca. £40, so giving an average range of ca.£29 (see Figure 3).

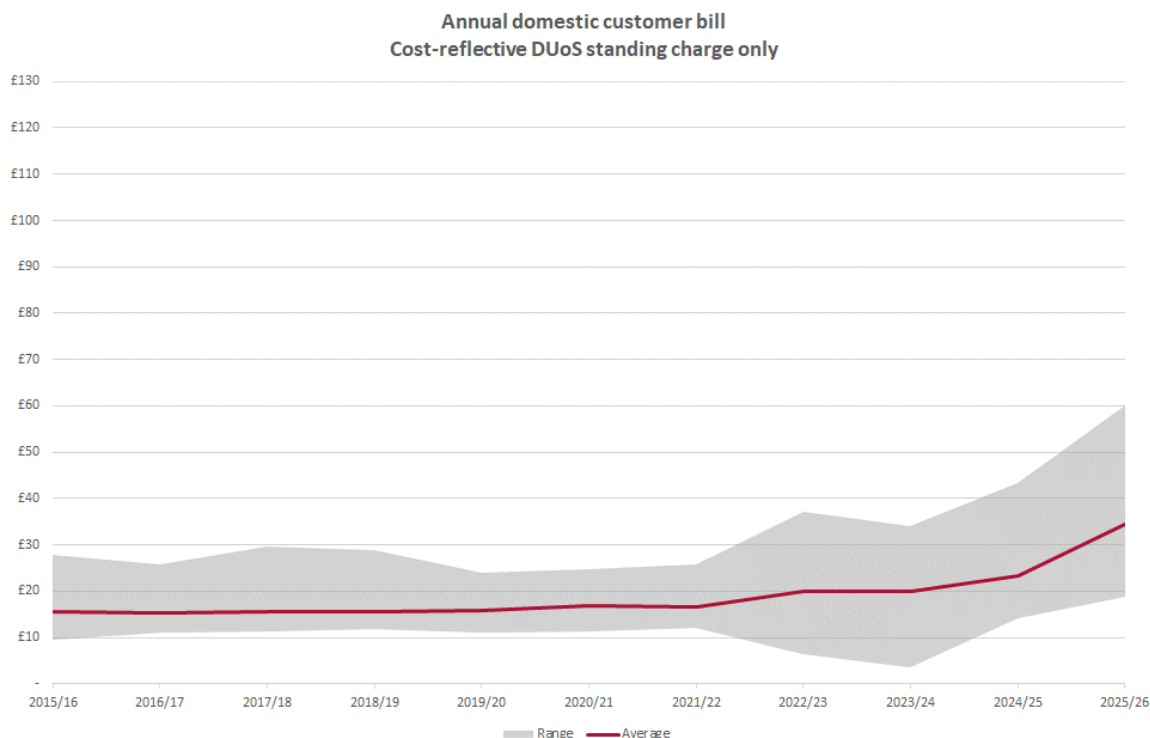


Figure 3: Annual cost-reflective DUoS standing charge for a domestic across all DNOs customer

⁸ Based on annual usage of 2,900kWh, which remains representative of average usage in Northern Powergrid’s regions

22. When including the “residual” charge component, the average minimum DUoS standing charge since 2021/22 is ca. £10 per annum,⁹ with the average maximum equivalent being ca. £79, so giving an average range of ca. £69 (see Figure 4).

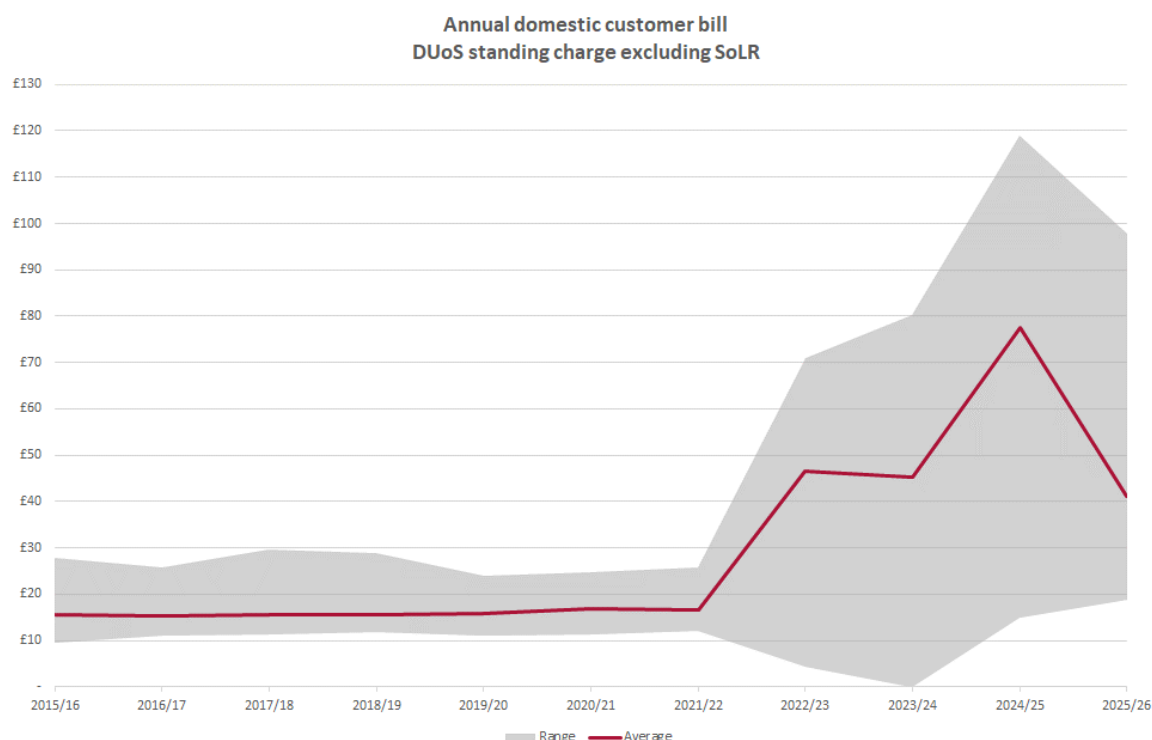


Figure 4: Annual cost-reflective plus residual DUoS standing charge for a domestic customer across all DNOs

23. The methodology for calculating DUoS charges for LV and HV customers is fundamentally an allocative approach based on a hypothetical network model (the “500MW model”) representing the capital costs of creating a new (on Greenfield land) 500MW increment to each DNO’s existing network. Costs are allocated to customer “types” based on their contribution to system simultaneous peak load, and separately relative to sole use service assets.
24. The ranges shown in both Figure 3 and Figure 4 are primarily representative of variations in:
- Modern equivalent asset values associated with the 500MW model and service assets;
 - Network topology;¹⁰
 - The 500MW model itself;¹¹
 - Peak demand across different “types” (and therefore number) of customers; and
 - The level of allowed revenue to be recovered from DUoS charges.¹²
25. Regional variations in DUoS charges are, therefore, generally representative of differences between the networks in terms of asset value/cost, size, and the mix of customers served.

⁹ The minimum is lower when including the residual due to the negative residual for some DNOs.

¹⁰ For example, networks vary in terms of length of overhead lines and underground cables.

¹¹ It is not a prescribed model unlike the overarching charging methodology, but instead determines inputs into that model in line with the methodology.

¹² For example, revenue from incentives and true-ups plus underlying profiling.