

Ofgem's Standing Charges: Call for Input

Executive summary

We recognise that the current level of a customers' electricity bill is a source of hardship for many people across the country. As Ofgem recognise in its call for input ("CFI"), the principal cause of this is high wholesale energy costs impacting unit rates. Whilst network standing charges have also risen, we do not believe these costs should be avoided by anyone connected to the electricity network. ENA support steps to ensure that electricity is affordable for all customers while maintaining cost reflective price signals for use of the network through a mix of reasonable standing charges and targeted support to those that government determines need it. Below we set out average annual distribution use of system ("DUoS") charges for a domestic customer, what these charges are formed of and how they are anticipated to change in the near term. We believe there is a need to promote greater transparency of the level of standing charges and what they are for.

Electricity network costs represent a significant investment and a natural high level of fixed costs that are recovered over a long asset life. These costs are recovered primarily through DUoS charges, and since implementing Ofgem's Targeted Charging Review ("TCR") (in 2022/23) the balance between volumetric (p/kWh) and standing (p/day) charges better reflects this. As customers increasingly rely on electricity for transport and heating, it is important that the correct balance between these charges is struck to provide the best outcomes for customers and the country.

We agree that standing charges have a legitimate role to play and in part to fund increasing electricity network investment to support net zero. Standing charges should primarily represent costs that do not vary by energy usage and should therefore not influence user behaviour. Steps to reduce standing charges without regard to the nature of the underlying costs are likely to introduce distortions that have the potential to create undesirable outcomes. Ofgem should review how network costs are allocated as part of the DUoS Significant Code Review ("DUoS SCR") to better align cost-recovery with the primary drivers of those costs. This should reduce the size of the "residual" charge (albeit it may not reduce the overall standing charge) and therefore further remove what remains an inefficient cost signal that customers seek to avoid.

The DUoS standing charge has risen in recent years due to two primary reasons: first, the transfer of the "residual" charge element from volumetric charges to the standing charge, and second, the recent level of Supplier of Last Resort ("SoLR") costs resulting from supplier failures. However, the underlying DUoS standing charge remains stable, and it remains a relatively small proportion of the retail bill. It should be noted that DNOs pass on the DUoS standing charges to energy suppliers who then determine how to build this into their commercial offering for customers. The standing charges that energy suppliers levy upon their customers (domestic and non-domestic) include the DUoS element as well as additional costs (supplier operational fixed costs, metering, etc.). There is no mandated methodology for how suppliers pass through DUoS standing charges.

We share Ofgem's concern regarding the distributional effects of standing charges, specifically for those on lower incomes, but we do not believe that network charges are appropriate to address that concern. Targeted support should continue to be provided via government policy and retail charges.

Standing charges, network charges and the price cap

The underlying DUoS standing charge is stable across all DNOs

DUoS charges for all LV and HV customers (representing around 97% of revenue from DUoS charges) have on average targeted the recovery of around £6.8bn p.a. between 2021/22 and 2025/26, of which around:

- £2.9bn (around 40%) is recovered via volumetric (p/kWh) charges;
- £0.9bn (around 15%) is recovered via capacity (p/kVA/day) charges; and
- £3.0bn (around 45%) is recovered via standing (p/day) charges.

DUoS standing charges are typically made up of three elements:

1. **Cost reflective** (around £0.7bn (25%) on average p.a.) based mainly on the operating costs for sole use or service model assets (e.g. the low voltage service cable to an individual property), and an annuitized cost of local level assets such as the low voltage network circuits relating to a domestic property.
2. **Residual** (around £2.0bn (65%) on average p.a.) based on assignment to a charging band (single band for domestic) being the “top-up” difference between allowed revenue and the amount expected to be recovered via “forward-looking” charges.
3. **SoLR** (around £0.3bn (ca.10%) on average p.a.) primarily representing SoLR cost-recovery for suppliers i.e. these are not network costs. SoLR cost-recovery impacts domestic customers only given that it is those customers that benefit from the SoLR protection and the costs are allocated to the standing charge given they do not vary by usage and should be paid for by all. DUoS bad debt recovery operates through a similar mechanism but concerns less material amounts.

Fluctuations in DUoS standing charges have primarily been driven by the residual change, which was effective from 1 April 2022 following implementation of Ofgem’s TCR. Whilst the SoLR component has been material in recent years – where DUoS charges recovered c.£1bn in 2022/23, with a further c.£0.3bn in 2023/24 and c.£0.1bn in 2024/25 – this has reduced to around £9m in 2025/26¹; and is expected to remain of low materiality in future. DUoS revenue from the “cost-reflective” standing charge has remained relatively stable over the same period.

The DUoS standing charge for a domestic customer was on average around £17 p.a. in 2021/22, which increased to around £81 in 2022/23 – primarily driven by the TCR (i.e. reallocating costs and not necessarily representing an increase) plus the addition of around £35 relating to SoLR cost-recovery. This reduced to around £55 p.a. in 2023/24 (the SoLR element reduced to around £9) and will increase to around £78 p.a. in 2024/25 – primarily driven by the recovery of prior year “under-recovery” driven by higher inflation after having provided 15 months’ notice of DUoS charges. The residual charge can be volatile as it varies to reflect changes in collected and allowed revenues. The requirement to provide 15 months’ advance notice of DUoS charges exacerbates this volatility. The DUoS standing charge for a domestic customer will reduce to around £41 p.a. in 2025/26 – primarily driven by a lower residual charge. See Table 1 for more information.

£p.a.	2021/22	2022/23	2023/24	2024/25	2025/26
Total DUoS standing charge	£16.66	£81.17	£54.68	£78.28	£41.19
<i>Cost-reflective</i>	£16.62	£20.07	£20.73	£23.32	£34.43
<i>Residual</i>	n/a	£26.39	£25.44	£54.25	£6.72
<i>SoLR</i>	£0.04	£34.71	£8.50	£0.71	£0.03

Table 1: Average annual DUoS standing charge for a domestic customer across all DNOs

Questions in Ofgem’s Call for Input

We have focused our response to questions 4 and 5 only within the remit of DUoS charges 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

¹ Via the “correction” (in isolation) of 2024/25 “under-recovery”.

access to gas and electricity networks. Is this fair? Should more be done to shield these customers from these costs?

A material proportion of electricity network costs are of a fixed nature. An example of such a fixed cost is that associated with providing a cable servicing a single property. Regardless of the amount of electricity consumed the cable needs to be in place while the customer has access to the network. To provide the customer with an economic signal that reflect the nature of this cost, it therefore makes sense to apply the associated charge as a standing charge. If the charge was volumetric, it would provide an economic signal that indicates this cost can be reduced by lowering consumption, which is not the case.

Since implementing the TCR, the DUoS standing charge represents around 50% of the total DUoS charge for a typical domestic customer. Whilst this may be a fairer reflection of the fixed nature of network costs, Ofgem should review the allocation of costs for the purposes of DUoS charges based on the primary driver of those costs (see Annex 1 for further detail); to avoid costs being allocated to the standing charge (or any charge for that matter) via the residual charge by default.

Regardless, DUoS standing charges should not discriminate between domestic customers relative to usage. Protection from high standing charges (or any charges) should continue to be determined by government policy and passed on via suppliers; who have a better understanding of their customers (e.g. ability to pay and other vulnerability indicators including eligibility for support schemes).

Government and other stakeholders should consider if there is a need to support fuel poor and vulnerable households with a low consumption of electricity when making future policy interventions. Care should be taken in the design of policies to ensure that support is targeted where it is most needed, and in a way where low consumption households are fully supported.

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

DUoS charges vary by region and represent different network topology (e.g. length of overhead and underground cables), asset value, and a varying customer base. Ultimately, these standard determining factors result in variations in the allowed revenue to be recovered by each DNO.

As the residual is recovered via the DUoS standing charge, the range between the lowest and highest annual DUoS standing charge across the DNOs (between 2021/22 and 2024/25) has increased on average to £66 p.a; whereas based on the cost-reflective element only, the range is around £26 p.a.

Annex 1: Allocation of Cost Proposal

This table was shared with Ofgem early in 2023 as a proposal to take forward under the DUoS SCR.

Area 1: Cost allocation

Context: Previous ENA work

The assessment of cost drivers under the Access and Forward-Looking Charges Significant Code Review (the "Access SCR") proposed that forward-looking charges should both (i) be determined by, and (ii) seek to influence user behaviour in relation to, *appropriate* costs only. How forward-looking charges are derived needs to recognise costs that both can and cannot be influenced by a user responding to a price signal. Where costs cannot or should not be influenced by user behaviour, costs should be allocated in such a way that does not seek to influence that behaviour, and not be allocated to the "residual" by default (or by virtue of potentially outdated and obscure assumptions).² The cost divers work sought to identify a solution where costs are allocated efficiently to different charge "types" (volumetric/capacity/fixed), and not specifically at reducing the quantum of the residual.

Context: Inefficient signals/unintended consequences

Ofgem's Targeted Charging Review ("TCR") SCR reformed residual DUoS charges insofar as determining how the residual should be recovered. The TCR did not seek to address the quantum of the residual but recognised that the associated materiality manifest as an inefficient price signal incentivising those that can, to avoid paying.³ Ofgem recognised that the review of forward-looking charges would address such signals; therefore the quantum of the residual could change by design.⁴

The TCR in effect replaced one price signal with another, due to the introduction of "banded" residual charges and therefore cliff-edge boundaries. As a result, some customers have been incentivised to relinquish network capacity in pursuit of paying less, and in some cases where demand was already significantly lower than the capacity "reserved" (suggesting a stronger incentive post-TCR to give-up spare capacity). Whilst it is not necessarily an undesired outcome for a customer to give back unneeded capacity, it should not be in response to a cost-recovery mechanism that seeks to avoid incentivising customer behaviour. Therefore, a desired outcome of the DUoS SCR should be to allocate costs more effectively such that the residual represents a fair allocation of costs that cannot reasonably be attributed to a specific "type" of charge and/or customer.⁵

Scope: Cost allocation granularity

The cost drivers work utilised cost granularity as reported to Ofgem annually per the Regulatory Instructions and Guidance ("RIGs") obligations to submit Regulatory Reporting Packs ("RPPs"), and recognised that some costs can arguably be closely/directly correlated with the (i) size, and (ii) number of

² The reference to "outdated and obscure assumptions" relates primary to the use of "standing charge factors" in the existing methodologies to determine the forward-looking charge.

³ The residual accounted for an average of c.35% of the revenue DNO's set both 2022/23 and 2023/24 DUoS charges to recover (ignoring LPN's negative residual): this increased to c.45% for 2024/25 DUoS charges.

⁴ The quantum of the residual typically varies under the existing methodologies primarily due to movement in Allowed Revenue.

⁵ Some costs may relate to certain "types" of customer only, therefore even if a clear cost-recovery basis does not exist, the costs should not be allocated via the residual and to all customers (that are a Final Demand Site). For example costs associated with the Supplier of Last Resort ("SoLR") mechanism are allocated to domestic customers only given non-domestic supply credit balances are not protected by the SoLR mechanism – however, the cost-recovery basis is considered appropriate via fixed charges given SoLR is a cost-recovery mechanism, and they are non-network costs.

customers connected to a DNO's network. However, it also recognised that some costs are loosely/indirectly correlated with a primary driver.

The analysis supported an approach to categorise costs on a "cost recovery" basis but concluded that some costs could be allocated to multiple "categories" and further work was needed – potentially at an even more granular cost level – and including consideration of how RRP costs align with the Allowed Revenue that DUoS charges are set to recover (as the RRP costs do not include e.g. the allowed return on investment, depreciation, tax allowances, incentives and regulatory "true-ups" etc).

However, whilst the RRP or an even more granular approach would arguably be more cost-reflective, an alternative approach is to consider the cost assessment at a much higher level, which may trade-off cost-reflectivity against practicality and proportionality.

One such approach is to link to the determination of Allowed Revenue via the Price Control Financial Model ("PCFM") and the "fast money" totex categories⁶ together with the other "Calculated Revenue" categories that principally combine to determine Allowed Revenue.

Scope: Allocation to "type" of (i) charge and/or (ii) customer

The ENA cost drivers work focussed primarily on the allocation of costs to different types of charge. It is possible to amend the approach of allocating costs to the different types of charge whilst leaving the core approach unchanged for allocating costs to different voltages and therefore type of customers, i.e. focus more on "how" a customer pays as opposed to "who" pays.

Charges for low voltage ("LV") and high voltage ("HV") customers ("Designated Properties")⁷ are determined by the Common Distribution Charging Methodology ("CDCM") which allocates costs to customers primarily using a hypothetical 500MW model (the "500MW model").⁸ The 500MW model represents capital costs associated with creating a new (on Greenfield land) 500MW increment to a DNOs existing network, and allocates annuitised capital costs and annual operating costs to different types of customer in accordance with that customer type's estimated contribution to system simultaneous peak load. Costs are also allocated to customers relative to service models (representing the cost of sole use connection/extension assets) and other operating costs. However, it is the 500MW model that is typically the primary driver of changes in charges between customer types.

A change in "who pays" could represent a fundamental overhaul of the 500MW model – perhaps replacing it with a different approach entirely – or it could represent the inclusion of asset replacement costs and/or obligating DNOs to use a standard model (i.e. bring the model into the Distribution Connection and Use of System Agreement ("DCUSA") as per the CDCM and EDCM models).⁹

⁶ E.g. load-related capex, non-load related capex – asset replacement, non-load related capex – other, faults, tree-cutting, 100% 'revenue pool' expenditure, and controllable opex.

⁷ Charges for Designated EHV Properties in accordance with the Extra-high voltage ("EHV") Distribution Charging Methodology ("EDCM") are determined by two different approaches: Long-Run Incremental Cost ("LRIC") and Forward Cost Pricing ("FCP"); and are not considered in this paper.

⁸ The 500MW model represents costs to develop a large increment to the existing network as a proxy for reinforcement costs, and asset replacement costs are excluded (which would be significantly more expensive at LV e.g. replacing underground cables in densely populated areas compared to overhead lines in rural areas etc).

⁹ In isolation, DNOs using a standard 500MW model may not necessarily change "who pays" but would improve transparency; noting it may be necessary to either (i) use common asset costs or (ii) retain some elements which are not fully transparent.