

# **Appendix 4: Industry Charges**

# Contents

| Acı | cronyms2  |                             |  |  |
|-----|---|-----------------------------|--|--|
| 1.  | Introduction<br>Background<br>Summary of our proposals<br>Structure of the appendix                                       | <b>. 3</b><br>3<br>4<br>6   |  |  |
| 2.  | Context   | <b>. 8</b><br>8<br>9        |  |  |
| 3.  | Proposed approach to setting the allowance<br>Context<br>Proposals<br>Summary of stakeholder responses<br>Considerations  | <b>11</b><br>11<br>12<br>12 |  |  |
| 4.  | Charges for inclusion and their calculation<br>Context<br>Proposals<br>Summary of stakeholder responses<br>Considerations | 16<br>16<br>18<br>18        |  |  |

# Acronyms

| Acronym | Name   |
|---------|--|
| BSC     | Balancing and Settlement Code                                  |
| CDSP    | Central Data Service Provider                                  |
| СоМСоР  | Consolidated Metering Code of Practice                         |
| СРІН    | Consumer Prices Index including owner occupiers' housing costs |
| CUSC    | Connection and Use of System Code                              |
| DCUSA   | Distribution Connection and Use of System Agreement            |
| DCC     | Data Communications Company                                    |
| DESNZ   | Department for Energy Security and Net Zero                    |
| мннѕ    | Market-wide Half Hourly Settlement                             |
| REC     | Retail Energy Code   |
| RECCo   | Retail Energy Code Company                                     |
| SEGB    | Smart Energy Great Britain                                     |
| SMICoP  | Smart Meter Installation Code of Practice                      |
| SMNCC   | Smart Metering Net Cost Change                                 |

# 1. Introduction

#### **Chapter summary**

This chapter sets out the context for the review of industry charges as part of our operating cost allowances review, a summary of our proposals, and the structure of the remaining chapters.

# Background

- 1.1 Energy suppliers are required to pay charges to various industry bodies in supplying customers with energy. Some of these charges relate to the maintenance of the industry codes that energy suppliers are required to sign up to and comply with (such as the Balancing and Settlement Code (BSC)), and are typically paid to industry code administrators (such as Elexon). Suppliers also pay charges to industry bodies that provide essential services to the industry (such as Xoserve, which is the Central Data Service Provider (CDSP) for the gas market).
- 1.2 Every year, industry bodies set out their expenditure for the next financial year in business plans. They also set out the charges that will be levied on suppliers, reflecting the share of expenditure that suppliers must pay for.<sup>1</sup>
- 1.3 Industry bodies' business plans are typically subject to a consultation process, which provides suppliers with an opportunity to make any representations on the draft budget.<sup>2</sup> However, in practice suppliers have limited control over the level of industry costs. In context of this, we refer to these costs as "pass-through industry charges".
- 1.4 In our May 2024 policy consultation 'Energy Price Cap: Operating cost allowances review' (**'our May 2024 policy consultation'**), we said we would review our approach to setting forward-looking allowances for these pass-through industry charges.<sup>3</sup> This included:
  - whether the charges should be captured in the operating cost allowance;
  - what charges we would set an allowance for; and

 $<sup>^{\</sup>rm 1}$  In some cases, the charges might be included in the business plan, rather than a separate charging statement.

<sup>&</sup>lt;sup>2</sup> The Data Communications Company (DCC) follows a different process, given its costs are subject to an ex post price control every year.

<sup>&</sup>lt;sup>3</sup> Ofgem (2024), Energy price cap operating cost allowances review, Chapter 6. <u>https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-allowances-review</u>

- how we would update the charges over time.
- 1.5 This document sets out our proposals, having considered the feedback received in response to our May 2024 policy consultation.

#### **Summary of our proposals**

- 1.6 Below, we provide a summary of our proposals. The considerations behind our proposals, along with the consideration of any feedback received, are detailed in Chapter 3 and Chapter 4 of this document.
- 1.7 We propose to set an allowance for industry charges as a separate pass-through component going forward, to be updated every six months using publicly available charging statements.<sup>4</sup>
- 1.8 We propose to set a pass-through industry charge allowance for costs related to Elexon, Xoserve, the Retail Energy Code Company (RECCo) and the Distribution Connection and Use of System Agreement (DCUSA), alongside the existing passthrough Smart Metering Net Cost Change (SMNCC) allowance for the Data Communications Company (DCC) and Smart Energy GB (SEGB).
- 1.9 We propose to remove the allowance for costs related to the Smart Metering Installation Code of Practice (SMICoP), as this has been superseded by the Consolidated Metering Code of Practice (CoMCoP) and CoMCoP costs are now included under RECCo charges.
- 1.10 We propose to allocate charges equally across payment methods, and to allocate costs between standing charge and unit rate based on the ratio that we have used for the operating cost allowance under the existing default tariff price cap ('the cap') methodology (around 51% for electricity and 73% for gas).
- 1.11 We propose to expand the scope of 'Annex 5 Smart metering net cost change allowance methodology' to include pass-through industry charges, and to rename the Annex 'Annex 5 – Smart metering net cost change and industry charge allowance methodology'.
- 1.12 We propose to maintain six-monthly updates of Annex 5 and use draft charging statements (or draft business plans) where final statements/plans may not yet be available, akin to the existing approach for DCC and SEGB cost allowances.

<sup>&</sup>lt;sup>4</sup> Or updated using publicly available business plans where charges may not be included in a separate charging statement.

- 1.13 We propose not to adopt a true-up/down mechanism to account for over- or under-recovery of costs, for example due to short notice changes to budgets.
- 1.14 In relation to the calculation of DCC and SEGB pass-through charges, we propose to move away from a net basis calculation and start calculating these allowances on a total basis.
- 1.15 We propose to use the sub-national electricity and gas consumption statistics from the Department for Energy Security and Net Zero (DESNZ) as the source of meter data in the calculation of Xoserve and DCUSA charges.<sup>5, 6</sup> This data source is currently used in Annex 5 for the calculation of DCC and SEGB charges.
- 1.16 Table 1 below sets out the proposed total pass-through industry charge allowance for Elexon, Xoserve, RECCo and DCUSA costs, alongside the existing allowance for DCC and SEGB, and compares it to the current allowance for industry charges at cap 13a. Table 2 sets out the proposed level of industry charge allowance. The updated allowance for Elexon, Xoserve, RECCo and DCUSA costs amounts to around £4 for a dual fuel customer (at benchmark consumption), or an approximately £3 increase on the existing allowance at cap 13a.

Table 1: Proposed total pass-through industry charge allowance based on datafrom final business plans for 2024/25 (nominal prices) (£ per customer)

| Fuel type   | Proposed<br>allowance –<br>Nil | Proposed<br>allowance –<br>Benchmark | Change vs<br>Cap 13a -<br>Nil | Change vs<br>Cap 13a –<br>Benchmark |
|-------------|--------------------------------|--------------------------------------|-------------------------------|-------------------------------------|
| Electricity | 8.72                           | 17.20                                | -0.32                         | +1.64                               |
| Gas         | 9.98                           | 13.71                                | +1.02                         | +1.16                               |
| Dual fuel   | 18.69                          | 30.90                                | +0.70                         | +2.81                               |

Note: Benchmark consumption is equal to 3,100 kWh for single-rate electricity, 12,000 kWh for gas and 4,200 kWh for multi-rate electricity. Values displayed are the same across payment methods (Standard Credit, Direct Debit and Prepayment Meter) and are shown for single-rate metering arrangement. Proposed allowance values for multi-registered metering arrangement are £8.90 (electricity), £9.98 (gas), and £18.88 (dual fuel) per

<sup>5</sup> Department for Energy Security and Net Zero (2024), Regional and local authority electricity consumption statistics – Sub-national electricity consumption statistics 2005 to 2022. <u>https://www.gov.uk/government/statistics/regional-and-local-authority-electricity-consumption-statistics</u>

<sup>&</sup>lt;sup>6</sup> Department for Energy Security and Net Zero (2024), Regional and local authority gas consumption statistics – Sub-national gas consumption statistics 2005 to 2022. https://www.gov.uk/government/statistics/regional-and-local-authority-gas-consumption-statistics

customer at nil consumption, and £17.55 (electricity), £13.71 (gas), and £31.26 (dual fuel) per customer at benchmark consumption. Values may not sum due to rounding.

# Table 2: Proposed pass-through industry charge allowance at benchmark consumption by industry charge based on data from final business plans for 2024/25 (nominal prices) (£ per customer)

| Industry charge | Electricity | Gas   | Dual fuel |
|-----------------|-------------|-------|-----------|
| Elexon          | 1.00        | -     | 1.00      |
| Xoserve         | -           | 1.17  | 1.17      |
| RECCo           | 0.90        | 0.90  | 1.80      |
| DCUSA           | 0.04        | _     | 0.04      |
| DCC             | 14 53       | 10.92 | 25.45     |
| SEGB            | 0.73        | 0.72  | 1 45      |
| Total           | 17.20       | 13.71 | 30.90     |

Note: Values displayed are the same across payment methods (Standard Credit, Direct Debit and Prepayment Meter) and are shown for single-rate metering arrangement. Values for multi-registered metering arrangement are £1.36 for Elexon, and £17.55 for total electricity and £31.26 for total dual fuel per customer at benchmark consumption. Values may not sum due to rounding.

## Structure of the appendix

- 1.17 The structure of the remaining chapters is set out below:
  - **Chapter 2 Context.** In this chapter, we set out the current approach to calculating an allowance for industry charges, and the case for change.
  - Chapter 3 Proposed approach to setting the allowance. In this chapter, we set out our proposal to set pass-through industry charges as a separate allowance based on industry body charging statements (or, where not available, business plans), rather than incorporating these costs into the core operating cost element of the allowance. We also discuss how we propose to update the allowance over time. We summarise and discuss any relevant stakeholder responses.
  - Chapter 4 Charges for inclusion and their calculation. In this chapter, we set out the list of industry charges we propose to include in the passthrough allowance and our proposed calculation for each charge. We summarise and discuss any relevant stakeholder responses. We also discuss

future changes in the regulatory landscape that could impact on the allowance for industry charges.

# 2. Context

#### **Chapter summary**

In this chapter, we set out the current approach to calculating an allowance for industry charges under both the operating cost allowance and the SMNCC allowance. We outline the case for change.

# **Current approach**

- 2.1 When the cap came into effect in 2019, we included an allowance to suppliers for industry charges in two areas: the operating cost allowance and the SMNCC allowance.
- 2.2 As part of the operating cost allowance, we included an allowance for the cost of Elexon, the code administrator of the BSC, and Xoserve, the CDSP for the gas market.<sup>7</sup> We set the allowance using 2017/18 charging statements and standardised it as a cost per customer, to ensure comparability across suppliers. The estimated charge we set in our 2018 decision was £0.23 per electricity customer for Elexon and £0.69 per gas customer for Xoserve. We indexed the allowance to be updated by inflation (measured using the Consumer Prices Index including owner occupiers' housing costs (CPIH)) at each relevant cap update, to allow for changes in costs.
- 2.3 When setting the cap, we included an allowance for pass-through smart metering charges, which covered the cost of DCC, SEGB, and SMICoP.<sup>8</sup> We set this allowance to be updated using charging statements (for DCC) and budget plans (for SEGB), which accurately reflected the costs suppliers incurred. The allowance for SMICoP was based on an annual budget assumption of £250,000, which was provided to us by SMICoP at the time.
- 2.4 In line with the approach for the rest of SMNCC, the allowance for pass-through smart metering charges is calculated as a net change between the baseline data year (2017) and each cap period we set. This is to account for the fact that there were smart metering costs in the operating cost baseline that we were unable to accurately remove before setting the allowance in 2019.

 <sup>&</sup>lt;sup>7</sup> Ofgem (2018), Appendix 6 – Operating costs, paragraph 2.3. <u>https://www.ofgem.gov.uk/decision/default-tariff-cap-decision-overview</u>
 <sup>8</sup> Ofgem (2018), Appendix 7 – Smart metering costs, paragraph 2.15. <u>https://www.ofgem.gov.uk/decision/default-tariff-cap-decision-overview</u>

## **Case for change**

2.5 In our May 2024 policy consultation, we noted that Elexon and Xoserve costs have increased at a greater rate than CPIH, as shown in Table 3 below. However, we noted that these differences are of low materiality (0.54% and 0.21% of the operating cost allowance per electricity and gas customer respectively based on data from 2024/25 business plans and charging statements) and may well balance out with downward trends in other cost lines within the operating cost allowance.

| Table 3: Comparison between Elexon and Xoserve 2024/25 nominal charges to |
|---|
| suppliers and our allowance (£ per customer)                              |

|         | Charge to<br>suppliers | Our allowance | Difference | % of operating<br>cost allowance |
|---------|------------------------|---------------|------------|----------------------------------|
| Elexon  | £1.00                  | £0.30         | £0.71      | 0.54%                            |
| Xoserve | £1.17                  | £0.90         | £0.27      | 0.21%                            |

Notes: The "charge to suppliers" figures are calculated from Elexon's business plan for 2024/25 and the CDSP charging statement for 2024/25.<sup>9 10</sup> The "% of operating cost allowance" figures are calculated as a proportion of the electricity and the gas operating cost allowance respectively. Values may not sum due to rounding.

- 2.6 We note that the purpose of our review of industry charges is to set a forwardlooking allowance, rather than to review whether the historical allowances were appropriate. We do not consider there is a need to correct for historical mismatching between the allowances and actual costs, because our data suggests overall that our operating cost allowance has in recent years been slightly higher than costs at a weighted average benchmark. See 'Appendix 1: Core operating costs' for further details.
- 2.7 In our May 2024 policy consultation, we also noted that our allowance does not explicitly account for costs of RECCo, the code administrator of the Retail Energy Code (REC). RECCo was set up in 2019, after the cap was introduced, and therefore its costs are not explicitly captured in our allowance. However, part of RECCo's role was to take on functions from other industry bodies, and we expect these industry bodies' costs may be captured in part in the allowance. Therefore, we noted that including RECCo charges now would likely be in part a reallocation of costs between industry bodies rather than a complete new set of costs.

<sup>&</sup>lt;sup>9</sup> Elexon (2024), Business plan 2024/25.

https://www.elexon.com/governance/reports-and-finances/business-plan/ <sup>10</sup> Xoserve (2024), CDSP Annual Charging Statement 2024-25 (30 January 2024). https://www.gasgovernance.co.uk/DSC-Documents

2.8 We also said we would explore whether to include an allowance for costs related to the Distribution Connection and Use of System Agreement (DCUSA).

# 3. Proposed approach to setting the allowance

#### **Chapter summary**

This chapter sets out our proposal to set a separate pass-through allowance for industry charges. We also discuss how we propose to update the allowance over time.

## Context

- 3.1 In our May 2024 policy consultation, we said we would focus our review on the approach to set allowances for Elexon, Xoserve and RECCo charges. This was because we considered the existing methodology for smart metering charges to be appropriate and reasonable, and to align with the option of setting industry charges using charging statements (option 2 below).
- 3.2 In our May 2024 policy consultation, we consulted on two options to set allowances going forward:<sup>11</sup>
  - Option 1: status quo Capture costs in the core operating cost baseline and update allowances in line with the methodology for core operating costs.
  - Option 2: new component Set a separate pass-through component using charging statements, which is regularly updated.
- 3.3 We said that our preference at this stage was for option 2.
- 3.4 We also said that as part of our review we would consider the appropriate timing of the updates to the industry charges allowance, noting that charging statements are often published on an annual basis.

## **Proposals**

- 3.5 We propose to set an allowance for industry charges as a separate pass-through component going forward, to be updated every six months using publicly available charging statements (option 2).<sup>12</sup>
- 3.6 We propose to allocate costs equally across payment methods, and to allocate costs between the standing charge and unit rate based on the ratio used for the

 <sup>&</sup>lt;sup>11</sup> Ofgem (2024), Energy price cap operating cost allowances review, paragraphs 6.18 – 6.29.
 <u>https://www.ofgem.gov.uk/consultation/energy-price-cap-operating-cost-allowances-review</u>
 <sup>12</sup> Or updated using publicly available business plans where charges may not be included in a separate charging statement.

operating cost allowance under the existing cap methodology (around 51% for electricity and 73% for gas).

- 3.7 We propose to expand the scope of 'Annex 5 Smart metering net cost change allowance methodology' to include the allowance for pass-through industry charges. We propose to rename it 'Annex 5 – Smart metering net cost change and industry charge allowance methodology' ('proposed Annex 5').
- 3.8 We propose to maintain six-monthly updates of the proposed Annex 5, and to use draft charging statements (or draft business plans) where final statements/plans may not be yet available to update the proposed Annex 5, akin to the existing approach for DCC and SEGB cost allowances.
- 3.9 We propose not to adopt a true-up/down mechanism to account for over- or under-recovery of costs, for example due to short notice changes to budgets.

### Summary of stakeholder responses

- 3.10 Eight suppliers and one industry body agreed with option 2 (ie setting a separate pass-through component using charging statements). Amongst advantages of this approach, stakeholders cited the accuracy of the approach, its simplicity, transparency, and resilience to future changes in the cost of industry bodies.
- 3.11 Two stakeholders disagreed with option 2, saying that setting up a new component would add unnecessary complexity and that the approach would remove suppliers' incentive to ensure these costs are efficient.
- 3.12 In addition, two suppliers suggested there should be a means of amending allowances to account for any over- or under-recovery of costs (for example, in the event of short notice changes in industry charges), such as an in-built true-up/down mechanism. One of these suppliers also suggested allowances should be updated quarterly.

#### Considerations

3.13 We propose to adopt option 2. Most stakeholders supported this approach, and we consider that the benefits in terms of accuracy of allowances, transparency, and overall simplicity outweigh any complication with setting up a new component. This approach will also allow us to transparently account for any future changes in industry charges. We note that Ofgem is in the process of

reforming energy codes, which could have an impact on future industry charges.<sup>13</sup> We discuss this further in Chapter 4.

- 3.14 One consumer group said that by making these costs pass-through, we would remove suppliers' incentive to ensure these costs are efficient. It noted that, if we were to go ahead with option 2, Ofgem would need to improve scrutiny of these charges, for example by introducing approval processes for industry bodies' budgets.
- 3.15 We recognise the potential detrimental impact on suppliers' incentives to challenge any inefficiency of industry bodies' budgets. However, we consider the trade-off is justifiable to ensure this part of the allowance is cost reflective. We note that suppliers have an incentive to mitigate the risk of mid-contract cost increases for fixed tariffs, as they commit to a price for the duration of the contract. Therefore, suppliers are incentivised to monitor the costs imposed by industry bodies and to challenge these costs where they consider it appropriate.
- 3.16 In relation to the point on scrutiny of charges, we note that industry codes are multiparty arrangements, and they are for industry parties to own and operate. We welcome any scrutiny consumer groups can provide as part of the budget consultation processes. We also note that, in addition to the consultation processes in place for Elexon, Xoserve, RECCo and DCUSA budgets, there are appeal routes in place for both RECCo and Xoserve budgets.
- 3.17 The same consumer group suggested we should lower the risk margin suppliers receive, because the cost risk would be passed on to customers. We note that the new pass-through industry charges are of low materiality (around £4), and that a review of the headroom allowance (ie the risk margin) is outside the scope of the operating cost allowance review. However, we note that the headroom allowance remains a potential long-term area of focus.<sup>14</sup>
- 3.18 We do not propose to differentiate by payment method when allocating industry charges. This is because industry bodies do not charge suppliers based on payment method. Therefore, we propose to allocate costs equally across Standard Credit, Direct Debit and Prepayment Meter customers. We consider this will reflect the cost allocation in charging statements.

 <sup>&</sup>lt;sup>13</sup> Ofgem (2024), Implementation of energy code reform: consultation decision. <u>https://www.ofgem.gov.uk/decision/implementation-energy-code-reform-decision</u>
 <sup>14</sup> Ofgem (2024), Energy price cap programme of work for 2024 and 2025. <u>https://www.ofgem.gov.uk/publications/energy-price-cap-programme-work-2024-and-2025</u>

- 3.19 For total pass-through industry charges (including DCC and SEGB), we propose to allocate costs between the standing charge and unit rate based on the ratio that we have used for the operating cost allowance under the existing cap methodology. This is around 51% for electricity and 73% for gas. We consider this appropriate because the majority of pass-through industry charges so far were included under the operating cost allowance (ie Elexon, Xoserve, and part of DCC and SEGB costs). Therefore, we consider this proposal would maintain continuity in our approach.
- 3.20 To set a separate allowance for pass-through industry charges, we propose to repurpose 'Annex 5 Smart metering net cost change allowance methodology'. This would bring consistency as Annex 5 already includes the pass-through cost allowance for SMNCC (alongside the non-pass-through SMNCC allowance). This would bring together the total allowance for pass-through industry charges. We have reflected these changes in the proposed Annex 5 published alongside this consultation.
- 3.21 We propose to maintain six-monthly updates of Annex 5 (February and August). We do not consider moving to quarterly model updates would be proportionate, given business plans are set once a year (to cover the period 1 April to 31 March). However, to minimise cash flow issues and allow us to capture the new levels of charges in a timely manner, we propose to use draft charging statements (or draft business plans) where final statements/plans may not be available in time for the February model update (as final business plans and charging statements are typically published between February and March). This is akin to the approach we take to set a pass-through allowance for DCC costs in Annex 5. We generally do not expect differences between draft and final plans/statements to be material.
- 3.22 We do not consider it would be proportionate to incorporate a true-up/down in Annex 5 to account for over or under-recovery of allowances (for example, due to short notice changes in budget). This is because of the low level of materiality of the new industry charges. We have also seen both increases and decreases to inyear budgets and consider that in the round, over- and under-spend could net

off.<sup>15, 16</sup> We also note that we include a headroom allowance in the cap to account for uncertain cost pressures that are not already included in our efficient benchmark. We have also set a weighted average benchmark across the operating cost review which we consider reduces the risk that small deviations would result in either resilience risks or under-recovery for an efficient supplier. As a result, we expect to maintain a position that any under-recovery risk would need to be systematic and material to trigger a review, and that our view on materiality will set a higher bar than had we adopted a lower quartile benchmark. See 'Appendix 1: Core operating costs' for further details.

<sup>&</sup>lt;sup>15</sup> In November 2023, Elexon announced an in-year budget increase of £3.7 million <u>https://www.elexon.com/documents/about/finances-report-policies/business-plan/2023-</u> 24/elexon-business-plan-2023-2024-amendment/

<sup>&</sup>lt;sup>16</sup> In October 2024, RECCo announced that underspend of £9.8m would be returned to funding parties.

https://www.retailenergycode.co.uk/2023-24-budget-underspend-of-9-8m-to-be-returned-tofunding-parties-in-october-2024-rebate/

# 4. Charges for inclusion and their calculation

#### **Chapter summary**

This chapter sets out a list of industry charges we propose to include in the industry charge allowance. We set out the proposed calculation of each charge and discuss some methodology issues we seek views on. We also set out future changes to the structure and charging arrangements of industry bodies which could impact our allowance.

## Context

- 4.1 In our May 2024 policy consultation, we said we could include a pass-through industry charge allowance for Elexon, Xoserve and RECCo, and proposed how to calculate each charge. We said we would explore whether to include DCUSA costs in the pass-through charges, and said we would consider removing the SMICoP (now CoMCoP) allowance as it is covered under RECCo charges.
- 4.2 We also said we would consider amending the calculation of smart metering passthrough costs as a net change relative to the 2017 baseline, either by updating the baseline year data or moving away from a net approach to set allowances on a total basis.

## **Proposals**

- 4.3 We propose to include a pass-through industry charge allowance for Elexon, Xoserve, RECCo and DCUSA costs, alongside the existing allowance for DCC and SEGB costs.
- 4.4 We propose to remove the separate SMICoP cost allowance going forward, given RECCo confirmed that CoMCoP costs are now included under RECCo charges.
- 4.5 We propose to use meter data from the sub-national electricity and gas consumption statistics from DESNZ to calculate Xoserve and DCUSA charges.<sup>17, 18</sup> This data source is currently used in Annex 5 to calculate DCC and SEGB charges.

<sup>&</sup>lt;sup>17</sup> Department for Energy Security and Net Zero (2024), Regional and local authority electricity consumption statistics – Sub-national electricity consumption statistics 2005 to 2022. <u>https://www.gov.uk/government/statistics/regional-and-local-authority-electricity-consumption-statistics</u>

<sup>&</sup>lt;sup>18</sup> Department for Energy Security and Net Zero (2024), Regional and local authority gas consumption statistics – Sub-national gas consumption statistics 2005 to 2022. https://www.gov.uk/government/statistics/regional-and-local-authority-gas-consumption-statistics

- 4.6 In relation to the calculation of DCC and SEGB pass-through charges, we propose to move away from a net basis calculation and start calculating these allowances on a total basis.
- 4.7 Figure 1 below presents a comparison of the current allowance for industry charges at cap period 13a (£28.10) and the total of proposed pass-through charges based on data from 2024/25 financial statements (£30.90). The difference is just under £3. We note our allowance is likely to be underestimated because we expect RECCo costs to be captured in part under our existing operating cost allowance. We also do not consider we need to correct for historical under-recovery, because our data suggests overall that our operating cost allowance has in recent years been higher than costs at a weighted average benchmark, as explained in Chapter 2.

# Figure 1 – Comparison of current allowance for industry charges at price cap 13a and proposed pass-through allowance based on data from final business plans for 2024/25 (nominal prices)<sup>19</sup> (£ per dual fuel customer)



Note: Values displayed are the same across payment methods (Standard Credit, Direct Debit and Prepayment Meter) and are shown for single-rate metering arrangement. Proposed allowances for multi-registered metering arrangement are £1.36 for Elexon, and £17.55 for total electricity and £31.26 for total dual fuel per customer at benchmark consumption. Values may not sum due to rounding.

 $<sup>^{19}</sup>$  The total proposed pass-through allowance for electricity and gas separately would be £17.20 and £13.71 per customer respectively.

Accessible format: This is a bar chart showing the current allowance at cap period 13a and the proposed passthrough allowance based on data from final business plans for 2024/25. The current allowance is £28.10 per dual fuel customer, which is comprised of DCC (£25.45), SEGB (£1.45), SMICoP (£0.01), Xoserve (£0.90), and Elexon (£0.30). The total pass-through allowance is £30.90 per dual fuel customer, which is comprised of DCC (£25.45), SEGB (£1.45), RECCo (£1.80), Xoserve (£1.17), Elexon (£1.00), and DCUSA (£0.04).

#### Summary of stakeholder responses

- 4.8 Stakeholders generally agreed with the list of charges we proposed for inclusion in the industry charge allowance and the public data sources we identified. Two stakeholders also agreed we should include an allowance for DCUSA costs.
- 4.9 One supplier noted that there are other codes which suppliers pay charges for beyond Elexon, Xoserve and RECCo, which Ofgem should consider for inclusion.

### Considerations

Charges for inclusion

- 4.10 We propose to include an allowance for industry charges related to Elexon, Xoserve and RECCo. Stakeholders agreed with this list.
- 4.11 One supplier noted that there are other codes which suppliers pay charges for beyond Elexon, Xoserve and RECCo, which Ofgem should consider for inclusion. The supplier did not refer to any charge in particular, but said that we should use Ofgem's list of industry codes as a starting point.
- 4.12 We reviewed the list of industry codes that suppliers are required to become a party to and/or comply with. Following this review, we propose to include an allowance for DCUSA charges, which are an operational cost to suppliers. We did not identify any other codes that suppliers pay for which are unaccounted for in our allowance. We note that we include the costs of some codes (such as the Connection and Use of System Code (CUSC)) in the network cost allowance, rather than the operating cost allowance.
- 4.13 We propose to remove the allowance for SMICoP costs. In its response to our policy consultation, RECCo confirmed that SMICoP (now CoMCoP) charges are included in the charges identified for RECCo in its statement.
- 4.14 One supplier suggested that Ofgem should reconsider the value of SEGB, with the Smart Meter Implementation Programme near its end. We note there is no clarity yet on the government plan beyond 2025. If the government were to consult on a

new framework, we may then consider any implications on our allowance for SEGB.

#### Calculation of the charges

- 4.15 One supplier said that our proposed calculation of the Elexon charge on suppliers did not reflect the actual share of costs borne by suppliers, which it said is higher. We reviewed our calculation of the Elexon charge. Suppliers share the cost of the Elexon budget with generators based on market volumes, except for Market-wide Half Hourly Settlement (MHHS) costs which are borne by suppliers only. We have updated our calculation to reflect this, so that suppliers bear c.60% of Elexon's budget costs, rather than half of the cost.
- 4.16 Table 4 below provides an overview of the calculation for Elexon, Xoserve, RECCo and DCUSA charges. We have also included an explanation of the methodology and unit adopted. This is in consideration of one supplier response which asked for clarity, given it said that the calculation of the Elexon charge in the May 2024 policy consultation was based on volume, while the calculation of the Xoserve and RECCo charges were based on supply points.
- 4.17 We have sense-checked each calculation with the relevant industry body (other than RECCo, which responded to our May 2024 policy consultation and agreed with the source and the charges identified for RECCo). The proposed calculation is reflected in the proposed Annex 5 we have published alongside this consultation.

| Industry<br>body | Activities funded   | Cost amount<br>(2024/25 nominal<br>prices)  | Methodology note   | Data source  |
|------------------|---|---|--|--|
| Elexon           | <ul> <li>BSC regular activity<br/>(including business as<br/>usual activity)</li> <li>Helix Programme</li> <li>MHHS</li> <li>Demand Led</li> <li>Digitalisation</li> <li>Teleswitch</li> <li>Energy Price Guarantee<br/>Scheme</li> </ul> | £1.00 per electricity<br>meter<br>Calculated as<br>[(total budget -<br>MHHS)/(total volumes)<br>+<br>(MHHS)/(supply<br>volumes)] * 3.1MWh<br>(or 4.2MWh for multi-<br>registered customers) | <ol> <li>Total budget costs less MHHS costs,<br/>divided by total generation and<br/>supply volumes. This gives a £ per<br/>MWh value.</li> <li>MHHS costs, divided by supply<br/>volumes. This gives a £ per MWh<br/>value.</li> <li>Sum 1) and 2) to calculate<br/>suppliers' total cost per MWh.</li> <li>To move from a volume basis to a<br/>meter basis, we multiply 3) by<br/>benchmark consumption value for<br/>single rate electricity (3.1MWh) and<br/>separately by the value for multi-<br/>registered electricity (4.2MWh). This<br/>gives a £ per meter value.</li> </ol> | Elexon 2024/25 business<br>plan <sup>20</sup><br>Table 1.1 – budget costs<br>Table 3.3 – volumes |

### Table 4 – List of industry charges with methodology and data sources

<sup>&</sup>lt;sup>20</sup> Elexon (2024), Business plan 2024/25. https://www.elexon.com/governance/reports-and-finances/business-plan/

| Industry<br>body | Activities funded   | Cost amount<br>(2024/25 nominal<br>prices)  | Methodology note   | Data source  |
|------------------|---|---|--|--|
| Xoserve          | <ul> <li>General Services (eg<br/>manage Shipper<br/>Transfers, Customer<br/>Relationship<br/>Management)</li> <li>Infrastructure (eg UK<br/>Link enhancements)</li> <li>Change (eg DSC Change<br/>budget)</li> </ul> | £1.17 per gas<br>customer<br>Calculated as<br>(shipper user<br>charge/number of gas<br>supply points)     | Shipper user charge (used as a proxy<br>for supplier costs) divided by the total<br>number of gas supply points. This<br>gives a £ per meter value.<br>We divide the shipper user charge by<br>the total number of gas meters<br>(domestic and non-domestic) because<br>shipper charges include both domestic<br>and non-domestic. | CDSP 2024/25 annual<br>charging statement <sup>21</sup><br>Table 4 – shipper users<br>charges<br>DESNZ Sub-national gas<br>consumption statistics <sup>22</sup><br>Table for year 2022 –<br>Number of meters (all<br>meters) |
| RECCo            | <ul> <li>REC Operations (Board costs, staff)</li> <li>REC Services (including Central Switching Services)</li> <li>Projects &amp; Workstreams (including MHHS)</li> <li>Change Allowance</li> </ul>                   | £0.90 per meter (gas<br>or electricity)<br>Calculated as<br>(energy suppliers<br>charge + MHHS<br>charge) | Sum of energy suppliers charge and<br>energy suppliers MHHS charge. This<br>gives a £ per Registrable Measurement<br>Point, ie meter point.  | RECCo 2024/25 business<br>plan <sup>23</sup><br>Table 1 – energy<br>suppliers charges  |

https://www.gasgovernance.co.uk/DSC-Documents

https://www.gov.uk/government/statistics/regional-and-local-authority-gas-consumption-statistics

<sup>23</sup> RECCo (2024), Our 2024-25 Budget.

<sup>&</sup>lt;sup>21</sup> Xoserve (2024), CDSP Annual Charging Statement 2024-25 (30 January 2024).

<sup>&</sup>lt;sup>22</sup> Department for Energy Security and Net Zero (2024), Regional and local authority gas consumption statistics – Sub-national gas consumption statistics 2005 to 2022.

https://www.retailenergycode.co.uk/introducing-our-2024-25-budget/

| Industry<br>body | Activities funded   | Cost amount<br>(2024/25 nominal  | Methodology note   | Data source   |
|------------------|---|--|--|---|
| DCUSA            | <ul> <li>Panel</li> <li>Panel Secretary</li> <li>Working Group</li> <li>Secretariat</li> <li>DCUSA Ltd</li> </ul> | £0.04 per electricity<br>meter<br>Calculated as<br>(supplier cost/number<br>of electricity meters) | Total supplier costs divided by total<br>number of electricity meters. This gives<br>a £ per meter value.<br>We divide total supplier costs by the<br>total number of electricity meters<br>(domestic and non-domestic) because<br>supplier charges do not distinguish<br>between domestic and non-domestic. | DCUSA 2024/25<br>approved budget <sup>24</sup><br>Section 5 – total amount<br>recoverable from<br>suppliers<br>DESNZ sub-national<br>electricity consumption<br>statistics <sup>25</sup><br>Table for year 2022 –<br>Number of meters (all<br>meters) |

 <sup>&</sup>lt;sup>24</sup> DCUSA (2024), Approved Budget 2024/25.
 <u>https://www.dcusa.co.uk/guidance-documents/annual-reports-and-accounts/</u>
 <sup>25</sup> Department for Energy Security and Net Zero (2024), Regional and local authority electricity consumption statistics – Sub-national electricity consumption statistics 2005 to 2022.

https://www.gov.uk/government/statistics/regional-and-local-authority-electricity-consumption-statistics

- 4.18 To ensure consistency in the source of meter data used across Annex 5, for the calculation of the Xoserve and DCUSA charges, we propose to adopt the source of meter data currently used in Annex 5 for the calculation of DCC and SEGB charges, ie the sub-national electricity and gas consumption statistics from DESNZ.<sup>26, 27</sup> We note there is a two-year lag between the charging year and the year that this meter data refers to (eg we would use meter data from 2022 to calculate the costs allowance for charges from the financial year 2024/25). We do not consider this lag to have a material impact because the number of meters should be broadly stable between years. There is also precedent for using this source since it is already adopted in Annex 5. However, we seek views on whether other sources of meter data might be more appropriate, such as the DESNZ smart meter dataset (which includes data on all types of meters) or information published by Elexon and the Joint Office of Gas Transporters on electricity and gas meters respectively.<sup>28, 29, 30</sup>
- 4.19 In relation to the calculation of DCC and SEGB pass-through charges, we propose to move away from a net basis calculation and start calculating these allowances on a total basis. We can do so because we have isolated and removed smart metering pass-through charges from the core operating cost baseline. This is mostly a cosmetic change (a reallocation of costs from the operating cost baseline to industry charges). However, it brings consistency with the approach we propose to take for the new industry charges. It also helps to clearly identify the cost allowance for total pass-through industry charges (smart metering and other). We have reflected the proposed approach in the proposed Annex 5 published alongside this consultation.

<sup>29</sup> Elexon (2024), Gross Supplier Market Share Data reports.

<sup>&</sup>lt;sup>26</sup> Department for Energy Security and Net Zero (2024), Regional and local authority electricity consumption statistics – Sub-national electricity consumption statistics 2005 to 2022. <u>https://www.gov.uk/government/statistics/regional-and-local-authority-electricity-consumption-statistics</u>

<sup>&</sup>lt;sup>27</sup> Department for Energy Security and Net Zero (2024), Regional and local authority gas consumption statistics – Sub-national gas consumption statistics 2005 to 2022.

https://www.gov.uk/government/statistics/regional-and-local-authority-gas-consumption-statistics<sup>28</sup> Department for Energy Security and Net Zero and Department for Business, Energy & Industrial Strategy (2024), Smart meter statistics.

https://www.gov.uk/government/collections/smart-meters-statistics

https://www.elexon.co.uk/data/gross-supplier-market-share-data-reports/ <sup>30</sup> Joint Office of Gas Transporters (2024), Final Allocation of Unidentified Gas Statement (for Gas Year 2024-25), Appendix 3.

https://www.gasgovernance.co.uk/sites/default/files/related-files/2024-03/final aug statement 2024-2025.pdf

4.20 One supplier raised concerns on the treatment of MHHS capitalised costs. We have addressed this in 'Appendix 1: Core operating costs'.

#### Future changes in the regulatory landscape

- 4.21 Ofgem and DESNZ are in the process of reforming the energy codes regulatory framework.<sup>31</sup> The proposed changes include code consolidation, and the replacement of the existing roles of code administrators and code panels with licensed code managers, who will be responsible for the governance of the codes. These changes are likely to impact the industry bodies and/or industry codes we set an allowance for, and consequently the list of charges we include in the allowance. RECCo flagged this in its response, noting that one option that Ofgem is recommending is the potential consolidation of the DCUSA and the CUSC to create an electricity commercial code.<sup>32</sup> RECCo said the cap should allow recovery of costs of the electricity commercial code in the future.
- 4.22 The timeline for implementation of the changes is still in development, although Ofgem has decided the implementation will proceed with a three-phase transition sequencing, with phase 1 concerning the BSC and REC.<sup>33</sup>
- 4.23 We may consider consulting on any material changes to the industry charge allowance once there is greater clarity on the timeline and impacts.
- 4.24 We also note there are a number of workstreams in progress which relate to DCC's costs and charging:
  - as part of its wider review of the regulatory arrangements for DCC, Ofgem is considering potentially moving from an ex post to an ex ante price control regime, with a plan to publish a consultation on the policy design in the upcoming months;<sup>34, 35</sup> and

https://www.ofgem.gov.uk/decision/dcc-review-phase-1-decision

<sup>&</sup>lt;sup>31</sup> Ofgem (2024), Implementation of energy code reform: consultation decision. <u>https://www.ofgem.gov.uk/decision/implementation-energy-code-reform-decision</u>

<sup>&</sup>lt;sup>32</sup> In August 2024, we set out our decision to consolidate CUSC and DCUSA to form an electricity commercial code.

Ofgem (2024), Implementation of energy code reform: consultation decision, Chapter 3. https://www.ofgem.gov.uk/decision/implementation-energy-code-reform-decision

 <sup>&</sup>lt;sup>33</sup> Ofgem (2024), Implementation of energy code reform: consultation decision, page 50.
 <u>https://www.ofgem.gov.uk/decision/implementation-energy-code-reform-decision</u>
 <sup>34</sup> Ofgem (2023), DCC review: Phase 1 Decision.

<sup>&</sup>lt;sup>35</sup> Ofgem (2024), DCC Review Phase 2: Governance and Centralised Registration Service arrangements, page 6.

https://www.ofgem.gov.uk/consultation/dcc-review-phase-2-governance-and-centralisedregistration-service-arrangements

- DCC is considering whether and how it might be appropriate to change the way it recovers the costs associated with operating the smart meter network, having published a request for information in April 2024 and with the plan to publish a follow-on consultation later this year.<sup>36</sup>
- 4.25 We will review whether the outcome of either of these workstreams has an impact on the recovery of DCC's charges through our industry charges allowance. If appropriate, we may consult on any material and systematic changes.

<sup>&</sup>lt;sup>36</sup> DCC (2024), DCC summary of responses to the DP218 'Review of the SEC Charging Methodology' RFI, page 4. <u>https://www.smartdcc.co.uk/consultations/dcc-summary-of-responses-to-the-dp218-review-of-</u>

https://www.smartdcc.co.uk/consultations/dcc-summary-of-responses-to-the-dp218-review-ofthe-sec-charging-methodology-rfi/