



## Northern Powergrid response to Ofgem's option paper standing charges: domestic retail options

### KEY POINTS

- We support Ofgem reviewing how costs are allocated – we have argued that this is essential for many years and believe that it should be taken forward 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).
  - Network standing charges should reflect costs that cannot or should not influence behaviour. This should not be achieved arbitrarily.
  - DUoS standing charges should not discriminate between domestic customers. Targeted protection based on a customer’s ability pay 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.
- We support Ofgem reviewing principles implemented via the Targeted Charging Review (TCR) – it comes as no surprise to us that the boundaries, compounded by the continued lack of reform to address materiality of residual charges, continues to influence customer behaviour.
  - The exceptional circumstances provisions to allow reallocation to other charging bands is unnecessarily burdensome on all parties – it should be simplified.
  - The associated materiality test may be driving unintended consequences – we do not believe it is always acting in the interests of customers or networks.
  - We maintain our long-standing view that the basis of allocating customers to charging bands should better reflect changes in a site’s maximum import capacity/annual usage. This has improved since implementing the TCR, but it hasn’t gone far enough.
  - Wider reform to address the quantum of residual charges, together with more appropriate reallocation principles, should finally embed TCR as business as usual.
- DUoS charges are necessarily different across the DNO regions due to the different mix of customer types and topology across the country.
  - On a like-for-like basis, the cost levied by each DNO would be the same.
  - Any alignment of DUoS charges would necessitate cross-subsidisation of network costs.

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## 1. Detailed responses to the questions

1. We have focussed our response within the context of DUoS charges to question 9 only.

*Q9 - Do you have any views on our considerations for the allocation of network and policy costs?*

### Review of 'cost' allocation

2. We support Ofgem reviewing how network costs are allocated. This is long overdue, and, as Ofgem knows, we have demonstrated clear appetite for change here, over many years.
3. Following implementation of Ofgem's Targeted Charging Review (TCR), we expected that, by now, the quantum of the 'residual' would have been addressed via reform to 'forward-looking' charges.
4. We have proposed options to achieve this (amongst other things), and we continue to believe that change is essential in how network costs are allocated; moving away from the notional '500 MW model' (the Distribution Reinforcement Model) approach to one which allocates cost (and revenue) allowances to their primary driver(s) and utilises standard industry data.
5. We believe that these shortcomings continue to drive issues in various guises: including higher network standing charges (e.g. in 2024/25) and 'surplus residual charges'.
6. Network standing charges should reflect costs that cannot or should not be influenced by user behaviour and are generally 'fixed' by nature. That is not how the charging methodologies are currently designed and this needs to be addressed as a priority.
7. Policy decisions to allocate fixed costs to volumetric charges must be transparent. Whilst we support assessment of progressive ways to recover network costs, we urge significant caution on any further 'banding' based on ability to pay.
8. Boundaries create inevitable gaming as perfectly highlighted by the implementation of the TCR, including the piecemeal code modifications from industry that seek to create opportunities to avoid costs that should not influence user behaviour.
9. Network standing charges should not discriminate between domestic customers – targeted protection should continue to be driven by government policy via supplier retail charges. Suppliers have a direct relationship with customers and have greater visibility of usage and vulnerability indicators (e.g. those eligible for the Warm Home Discount). 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.
10. We welcome Ofgem recognising the specific need to address these defects and encourage immediate progress; this needs to be joined-up and the Distribution Use of System (DUoS) Significant Code Review (SCR) should be the vehicle.
11. In its consultation, Ofgem refer to the electricity network cost component of standing charges including Supplier of Last Resort (SoLR) costs. For the avoidance of doubt, SoLR costs are not network costs, they are retail costs, and reflect a policy decision to recover those costs via network charges. Whilst we accept that SoLR cost-recovery has become embedded in network charges in recent years – driving a significant increase in our standing charges that are out of our control – network charges should not be the default mechanism to recover wider policy costs.

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**TCR banding**

12. We welcome consideration of the requirements for non-domestic sites to change band.
13. The implementation of the TCR and the charging bands has created a significant administrative burden via boundaries and materiality of 'residual' charges that have had the opposite effect by influencing user behaviour in efforts to avoid costs, that by nature – and as recognised by Ofgem – should not be avoidable.
14. We offer the following comments on our experiences since implementing the TCR:
  - a. Customers often do not understand requirements or do not provide the required documentation e.g. to certify as a Non-Final Demand Site (this can result in prolonged issue resolution).
  - b. It is difficult for a Final Demand Site to be able to reduce maximum import capacity (MIC)/consumption by more than 50%; however, this is arguably satisfying the TCR requirement to make circumstances for changing bands 'exceptional'.
  - c. We do not believe that it is an undesired behavioural response for a customer to release of unneeded capacity; the >50% materiality test disincentivises this if the reduction would be less than 50%. In some cases, it also risks customers reducing by more than 50% and running the risk of excess capacity charges (which whilst currently being equal to agreed capacity charges provides a negligible incentive to mitigate this risk).
  - d. We are not convinced that it should be necessary for the change in MIC/consumption to be due to a change in site use and/or configuration. We consider that it should be sufficient that there has simply been a change of more than the materiality threshold. DNOs are generally entirely reliant on the customer explaining the reason for changes in MIC/consumption such that this test is self-certified by the customer regardless.
  - e. For allocating a Final Demand Site to a charging band, we believe that using the latest MIC, rather than a 24-month average, would be fairer. This is particularly relevant where a reduction in MIC has not triggered the exceptional circumstances and therefore the full 24-months must be used, rather than just the period since the last change in MIC if exceptional circumstances have been met. Whilst the allocation process has been changed since implementing the TCR, to recognise where exceptional circumstances has resulted in a rebanding, we continue to believe that it would be more appropriate that DNOs should not blindly use a 24-month average. The materiality threshold could be included in the assessment whether the exceptional circumstances have been triggered or not (i.e. use proactively rather than just reactively). We believe the existing 'computer says yes' approach may be detrimental to customers, and effort should be made to allocate customers based on information more representative of current demand requirements. We pushed for this as part of implementing TCR, and time since passed has not convinced us that we were wrong.

**Variance in charges between DNOs**

15. As Ofgem is aware, DNO standing charges, and other components of the DNO element of the bill, are calculated through a national methodology that is approved by Ofgem. While the methodology is the same across the country, the end cost to customers varies. This is because each DNO region covers a different number of customers, a different mix of customer types and usage of the network and different geography, which means the construction of the network is varied. On a like-for-like basis, the cost levied by each DNO would be the same. We charge these

costs to electricity suppliers, and it is then their decision how they pass the costs on to customers

16. Charging the same DUoS charges to all customers regardless of region would require some centralisation of the charges. This is unnecessarily complicated, creates cross-subsidisation of network costs, and should be dealt with by government policy in retail charges, if desirable.