Making a positive difference
for energy consumers

Dr James Davies MP
House of Commons
London
SW1A 0AA

(by email only)

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Your ref: JD20732
Email: parliamentary.correspondence@ofgem.gov.uk

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Dear Dr Davies,

Thank you for your recent correspondence on behalf of your constituents, regarding standing charges. Your email has been passed to me to respond to, as a dedicated point of contact for elected representatives and their offices.

We know that many households are already struggling with energy costs on top of other cost-of-living challenges and, as a result, we are facing another tough winter.

We're doing everything we can within our powers to support customers ahead of this winter. We're working with suppliers to ensure they do all they can to support customers in debt, and we're working with consumer groups and charities to urge customers who are struggling to get in touch with their supplier early.

Standing Charges

We are especially aware of customer concerns over the level of standing charges.

Standing charges pay for important network build and maintenance projects, the cost of which must be shared fairly across the market. However, standing charges have increased over the last year or so, due to several factors, one of which is costs from the failure of several energy suppliers in 2021 and 2022.

These costs would still exist if the standing charge were to be scrapped. In previous reviews, we found that shifting costs to unit rate disproportionately impacts some customers who unavoidably have high demand. This includes customers with electric heating, renters in poorly insulated houses, customers with disabilities and those with families at home. The extra costs for these customers were far higher than the modest savings that customers with lower-than-average demand would see.

However, we recognise that customers are concerned about increasing standing charges and with that in mind, we are undertaking a programme of work to look at standing charges and the impact that they have on customers.

Regional Variations

There are regional differences as suppliers generally set prices based on differences in network charges. This means that the price you pay reflects how much it costs to transport energy to where you live. The cost fluctuates based on factors like the complexity of infrastructure, such as population density or demand in various distribution network regions. Cost-reflective charging within a network area is a reasonable way to share the costs for running and maintaining the energy network.

Part of the standing charge is to pay for network costs, and this is the means for licensed Distribution Network Operators to recover their allowed revenue. This is capped and regulated by Ofgem. Ofgem set allowed revenues for each of the 14 licence areas. These vary according to the size and characteristics of the network and other regional factors and their financing arrangements. When we set the price controls, we ensure these differences only exist on an efficient basis.

How are regional differences calculated?

- The network charge, including standing charge, is the means for licensed network companies to recover the allowed revenue, which is capped and regulated by Ofgem.
- The allowed revenue is different across DNO regions in GB, due to different requirements such as required investment and the operational cost for future forecasted demand (population) needs, which have regional differences.
- For distribution networks, the geography of the charging regions is determined by the licensed geographically defined area for each DNO.
- For domestic consumers, DNOs implement the Common Distribution Charging Methodology (CDCM) which gives the methods, principles, and assumptions underpinning

the calculation of Use of System Charges by each DNO Party (except where the DNO Party is acting as an LDNO).

- CDCM is part of DCUSA document which is regularly reviewed by Ofgem

Standing charges are not just the cost of distributing electricity from the distributor to the consumer, please see the below table which shows the components that make up the standing charge together with a description of the costs.

AA (Adjustment Allowance)	Covers any adjustments to the default tariff cap which differs from cap period to cap period.
PC (Policy Costs)	The costs related to government social and environmental schemes to save energy, reduce emissions and encourage take-up of renewable energy.
NC (Network Costs)	The regional costs of building, maintaining and operating the pipes and wires that carry energy across the country to your home. This causes the level of the cap to vary by region.
OC (Operating Costs)	The costs incurred for suppliers to deliver billing and metering services, including smart metering.
SMNCC (Smart Metering Net Cost Change allowance)	Accounts for the net impact of the smart meter rollout on suppliers' efficient operating costs.
PAAC (Payment method Adjustment Additional Cost)	The additional costs incurred through billing customers with different payment methods.
PAP (Payment method Adjustment Percentage)	Expresses the percentage uplift applied to the 'core benchmark'. The core benchmark consists of wholesale costs, operating costs, policy costs and network costs.
EBIT (Earnings Before Interest and Taxes)	A fair rate of return on suppliers' investments.
HAP (Headroom Allowance Percentage)	This allows suppliers to manage uncertainty in their costs.

Regional variations in energy charges

Charges referenced are for domestic consumers as published in the August 2023 price cap: Energy price cap (default tariff): 1 October to 31 December 2023 | Ofgem.

Types of network charges

The price cap includes three types of network charges:

Transmission charges (TNUoS) – for use of the national network.
Distribution charges (DUoS) - for use of the regional network.
Balancing charges (BSUoS) – for keeping the transmission system in balance in real-time.

Why does the price cap vary from region to region?

There are regional differences for electricity as suppliers generally set prices based on differences in network charges. This means that the price you pay reflects how much it costs to transport energy to the region you live in.

This varies due to the complexity of the infrastructure such as demand/population density of different distribution network regions. The price cap applies to all domestic consumers in a given region e.g. customers in Liverpool will face the same charges as those in North Wales as they are both in the SP Manweb region.

TNUoS

Everyone in GB is charged the same residual for TNUoS. This feeds through into standing charges, and means for TNUoS all households pay the same daily contribution to TNUoS. Unit charges for transmission are 0p/kWh in SP Manweb. Some of our Targeted Charging Review changes have changed the way these charges are produced, but for users the biggest change is a reduction in unit rates for network costs, and an increase in standing charges.

The Targeted Charging Review was launched to address problems where some demand users were using a number of approaches to avoid paying towards the common costs of the system, with the charge reductions they saw far exceeding the benefits of their actions in reducing network costs. We were concerned that in addition to this being unfair on other users, there was a high risk of cost escalation where charge avoidance and a reducing charging base created a feedback loop. Our changes moved much of the common costs from an extreme time-of-use charge that was very avoidable to fixed charges that are not.

TNUoS Standing charges correspond to the share of the overall costs that need to be paid to the networks each year (the allowed revenue) that are not picked up by generation charges or charges for using the system at different times (the cost-reflective or "forward-looking" elements). This amounts to c. £3.4bn to be picked up by daily fixed charges on domestic and non-domestic users. This is 77% of the overall £4.4 bn transmission allowed revenues.

DUoS

Standing charges for DUoS correspond to the share of the overall costs that need to be paid to the networks each year (the allowed revenue) that are not picked up by charges on using the system at different times (the cost-reflective or "forward-looking" elements, which make their way into unit rates).

In short, everything that doesn't come in through customers' unit rate-based DUoS charges has to be picked up by daily fixed charges on domestic and non-domestic users. Currently, this is c. £1.7bn, or 27% of the overall £6.5bn distribution allowed revenues.

Standing charge is marginally (c. 1%) higher in SP Manweb as DUoS is the only element in the standing charge that varies by region.

SP Manweb has highest overall DUoS charges in GB (including unit rate multiplied by assumptions about consumption volumes/times); c. 7% higher than next highest, North Scotland.

This is due to network configuration, which in SP Manweb is what is called a 'meshed network' which has a lot more interconnection through the voltage levels, in turn requiring more network infrastructure (switchgear, etc.) and ongoing operational costs. The distribution network region that Liverpool is in also covers more rural parts of the country, particularly in North Wales, with lower population densities to recover the associated costs.

BSUoS

'Gross' BSUoS charges are the same across GB but are there is a small variation across the country to adjust for the fact that transmission losses have a regional quality – the further the power is sent, the more losses are seen. BSUoS charges are set by the National Grid ESO, and when they come to charge each Supplier, they multiply the £/MWh charge by the consumption for each Supplier in each region. They adjust the consumption values for Suppliers to take into account that there are different degrees of loss at different parts of the system. We did not support this approach, but it was a result of the Competition and Market Authority's review of competition in the energy markets and was implemented on their instruction. SP Manweb has the highest BSUoS charges as it has the highest losses multiplier, c. 2% higher charges than South Scotland.

Network models indicate that SP Manweb has the highest loss of electricity when transported between generation and demand (collectively across the transmission and distribution network). The level of electrical loss is dependent on how the network is configured and how

lightly or heavily loaded the network is, and SP Manweb is a meshed network that has more assets to service a single customer relative to other networks. A level of electrical losses is inevitable in the normal operation of an electrical system. Ofgem do not hold any data on the level of electrical losses of any particular asset, and we have placed an obligation on Licensees to maintain electrical losses as low as possible.

Potential Future Solutions

One potential future solution could be locational marginal pricing, which is being considered as part of REMA (Review of Electricity Market Arrangements), a review currently being carried out by the government.

Locational wholesale pricing is a common electricity market design currently being considered by government. GB would move away from having a GB-wide wholesale price (or single price zone) to wholesale prices varying across GB (multiple price zones). Prices in each location would reflect local generation, demand and transmission constraints.

Typically, lower prices would occur in areas with high supply (eg lots of lower cost renewables) and lower demand, and higher prices in areas with high demand and/or more expensive generation. Locationally varying wholesale prices can incentivise market participants to make investment and operational decisions that lead to lower system costs and consumer bills, such as investing new generation in higher price areas or locating new demand (eg data centres) in areas with lower prices to reduce the need for expensive network upgrades. It is particularly effective in providing real-time operational signals, which would reduce the amount consumers pay when wind-farms need to be turned off and facilitate a step-change in the role for flexible demand (ie turning on EV charging when there is local excess generation).

How consumers across GB could be affected

Analysis (by Ofgem and others) indicate the potential for significant consumer savings from this market design – potentially billions a year. How much consumers across GB save will depend upon design and implementation – Ofgem analysis indicates the average consumer could be £56/pa better off, with consumers in the Highlands ~£69/pa better off, and consumers in Liverpool ~£35/pa better off.

Review of Standing Charges

We know standing charges have been contentious for a number of reasons, and that there is a public letter campaign on fairness, both in terms of their level and the fact that standing charges vary across different regions. This has always been the case because of the need to ensure that the charges are cost reflective, and it costs more to build and maintain the infrastructure to serve properties in certain regions than it does in others. However, we are looking at the issue of standing charges and will be launching some analysis of the standing charge in mid-Autumn, with a view to inviting responses on possible alternative models of allocating network charges to different types of domestic and non-domestic customers.

Thank you for writing to us on this matter. I hope this will provide some clarity and be of assistance towards reaching a resolution that will be helpful for your constituents.

Yours sincerely,

Catherine McDermott
Parliamentary Correspondence Officer