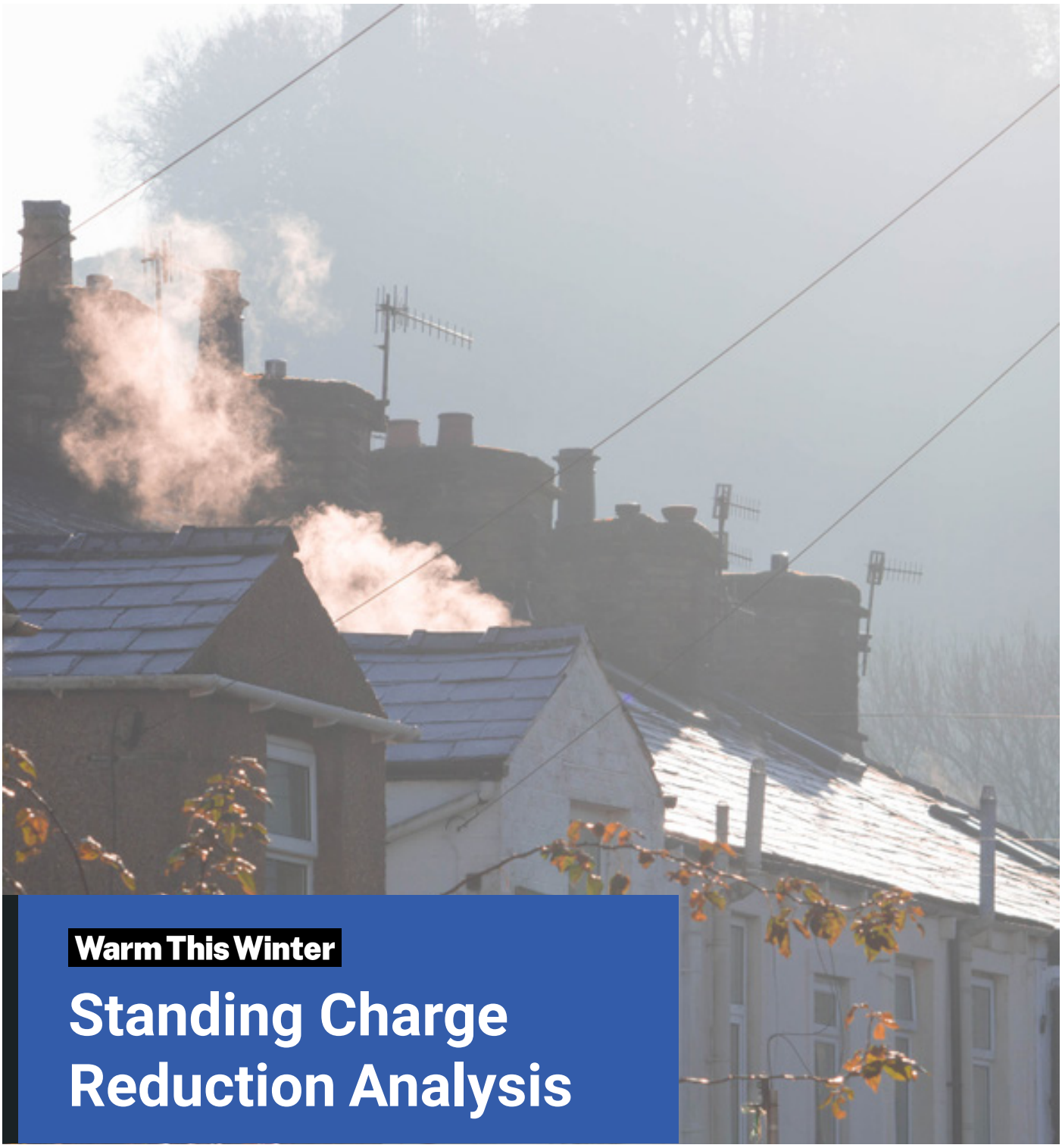
Future Energy Associates



**Warm This Winter**

# Standing Charge Reduction Analysis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# Executive Summary

## Increase in Standing Charges on Dual Fuel Bills

From January 2023 to July 2024, standing charges as a percentage of a dual fuel customer's bill have surged from 6.73% to 21.30%. In nominal terms, this represents an increase from £273.17 to £334.08 annually, under the Ofgem price cap. Currently, 64.78% of all operating costs are covered by the standing charge component of the bill. As a result, households pay £133.58 per year solely for the operating costs of their energy supplier, irrespective of energy consumption.

## Proposed Adjustments to the Ofgem Price Cap

This report recommends a revised Ofgem price cap for household energy bills on a Standard Variable Tariff (SVT) in July, suggesting it should be £1353.74 instead of £1567.96. Under this new formulation, the standing charge element of a household energy bill would be reduced from £334.08 to £183.02 for dual fuel tariffs per year. For electricity the standing charge would reduce from £219.42 to £149.17 per year and for gas the standing charge would reduce from £114.66 to £33.85 per year.

## Redistribution of Cost Elements

This report builds upon Ofgem's ongoing efforts to address the issues associated with standing charges on energy bills. Our approach explores a combination of reduction and abolition of standing charges, transitioning costs to general taxation, and shifting certain cost elements to unit rates. This comprehensive strategy aims to mitigate the negative distributional impacts previously identified by Ofgem, particularly those affecting vulnerable households. To achieve this adjustment, this report proposes the following:

- Transfer the adjustment allowance, headroom allowance, profit allowance, payment uplift, and levelling costs entirely to the unit rate section of the bill.
- Shift policy costs completely to general taxation.
- Revise the ratio of operating costs paid through standing charges versus unit rates.
- Reduce the standing charge elements of network costs by 10%, funded by excess shareholder profits.

**Additional Standing Charge Reductions Could be Possible in Network Costs:**

- This report finds a five-fold increase in standing charges relative to unit rates as a percentage of network costs in recent years. Detailed data on this is presented in the network costs section and could support those advocating for a shift back to unit rates.
- DUoS standing charge has increased more than 7 times since 2020, from £17.27 in April 2020 to £82.41 in April 2024. Before April 2022 DUoS standing charges made up less than 20% of the total DUoS charges, and post April 2022 standing charges made up more than 50% of the DUoS.
- Prior to 2022, the unit rate component of electricity network costs made up over 85% of electricity network costs and now they are less 35%
- The gas network costs have no component in the standing charge which highlights the inconsistency and lack of alignment from the regulator as to how network costs should be recovered by the network operators.

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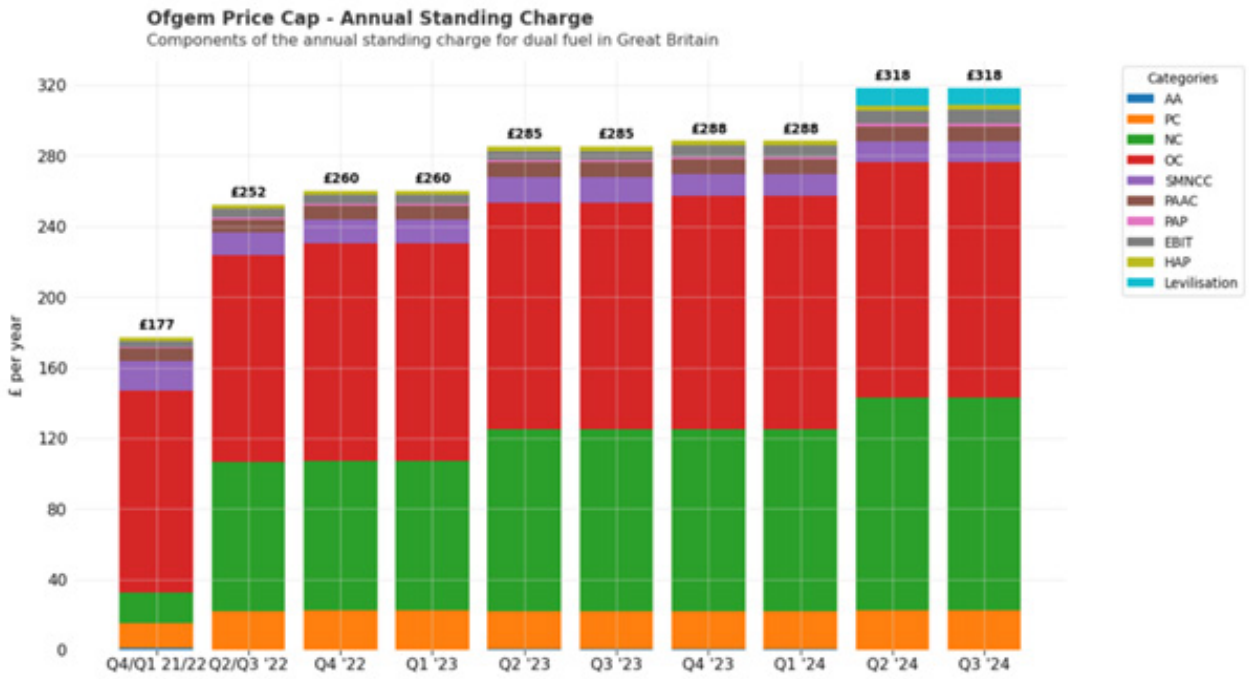
# Standing Charges Overview:

Standing charges are a fixed component of household energy bills, applied daily, regardless of energy usage. These charges in theory should cover the essential costs of maintaining a customer's connection to the energy grid, including infrastructure maintenance, administrative expenses, and contributions to various regulatory schemes. The standing charge is designed to ensure that energy suppliers can recover fixed costs that do not vary with consumption.

Ofgem's recent call for engagement with stakeholders aimed to explore potential changes to the standing charge framework. This includes considering the impact of standing charges on vulnerable customers and evaluating alternative models, such as rising block tariffs, which could offer a more equitable distribution of costs. Standing charges vary across regions due to differences in the cost of maintaining and operating local distribution networks. For example, the London region has historically had lower increases in standing charges compared to regions like MANWEB (Merseyside, North Wales and parts of Cheshire), which saw the largest increase.

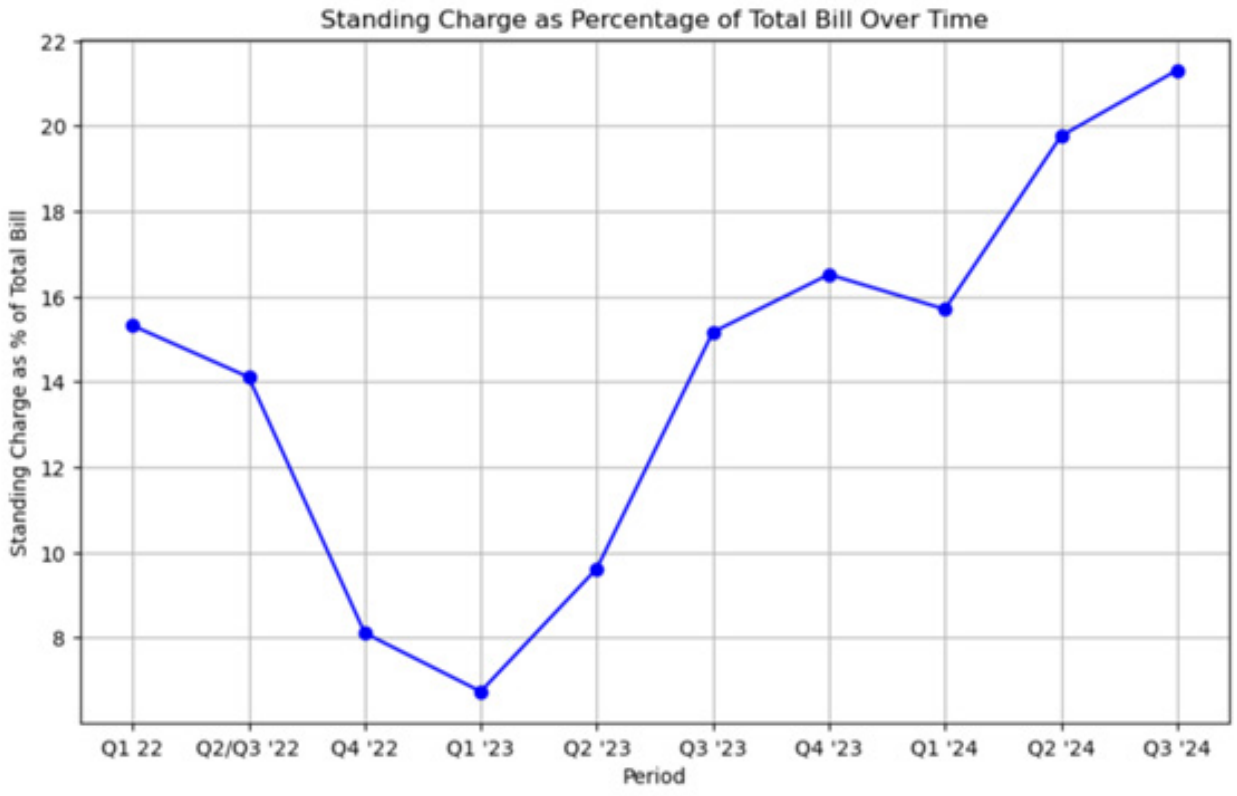



***Graph 1:*** *Ofgem Price Cap Standing Charges and Their Components (2021-2024) [1]*
*(Each component is excluding VAT)*

Since October 2021, standing charges in the UK energy market have undergone notable changes. The adjustment allowance (AA) started at £1.41 in October 2021, dropping to zero in April 2022, and briefly returning to £0.82 from April 2023 to March 2024, before settling back to zero from April 2024 onwards.

Policy costs (PC) saw a significant rise from £13.97 in October 2021 to £21.95 in April 2022, maintaining levels around £21 to £22 until September 2024. Network costs (NC) experienced the most substantial increase, jumping from £17.41 in October 2021 to £84.41 in April 2022, and continued to climb to £120.59 by July 2024. Operating costs (OC) also rose steadily from £114.03 in October 2021 to £133.58 by September 2024. The smart metering net cost change (SMNCC) decreased from £16.91 in October 2021 to £12.79 in April 2022, with slight fluctuations between £11.79 and £14.72 through September 2024.

Payment adjustment allowance credit (PAAC) increased gradually from £7.20 in October 2021 to £8.44 by September 2024, while the payment adjustment PPM (PAP) rose from £0.73 in October 2021 to £1.33 by September 2024. Earnings before interest and taxes (EBIT) saw an increase from £3.32 in October 2021 to £7.91 by September 2024, and the headroom allowance price (HAP) went up slightly from £2.31 in October 2021 to £2.71 by September 2024. Levilisation, initially at zero, was introduced in April 2024 at £9.89, and will decrease to £9.63 by September 2024. Consequently, the total GB average standing charge surged from £177.29 in October 2021 to an expected £318.18 by September 2024 (including VAT, £186.16 and £334.08 respectively).




***Graph 2:*** *Trend of Standing Charge as a Percentage of Total Energy Bill (2021-2024) [1]*

Graph 2 shows the standing charge as a percentage of the total energy bill from Q4/Q1 2021/2022 to Q3 2024. Initially, the standing charge was 15.32% of the total bill. This percentage declined to 6.73% by Q1 2023 due to a sharp increase in the Ofgem price cap, which caused overall energy bills to surge. Despite the absolute increase in standing charges, their proportion of the total bill decreased during this period.

From Q2 2023 onwards, the percentage began to rise again, reaching 21.31% by Q3 2024. This increase reflects the growing fixed costs and adjustments passed on to consumers. Regulatory changes by Ofgem, including price cap adjustments and cost redistributions, strongly influenced these trends.

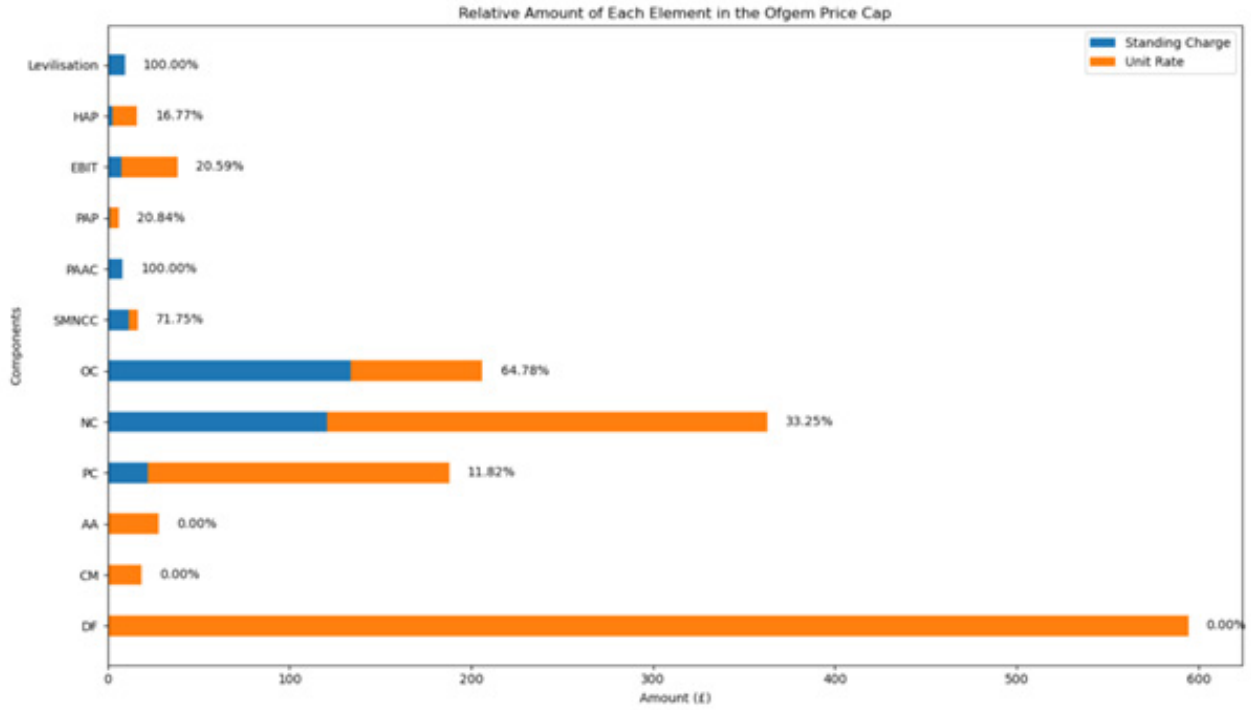
Overall, the rise in standing charges over this period can be primarily attributed to significant increases in network and operating costs. Adjustments in policy costs, EBIT, and the introduction of levilisation charges also contributed to the overall rise, reflecting broader cost pressures and regulatory adjustments within the energy sector. The increase in standing charges has a disproportionate impact on lower-income and low-consumption consumers, for whom fixed charges represent a higher percentage of the total bill compared to high-consumption users. This has raised concerns about fairness and equity in energy billing, prompting calls for a review and potential restructuring of how these costs are allocated.

# Revising the Ofgem Price Cap: Transitioning Costs to Unit Rates

This section will analyse which components within the Ofgem price cap should be shifted from the standing charge to the unit rate or general taxation. The goal is to create a more equitable distribution of costs, reducing the disproportionate burden on lower-income and low-consumption consumers. By examining each component of the price cap, we can identify which costs are more appropriately aligned with energy consumption and which could be better managed through alternative funding mechanisms. This approach aims to ensure that consumers pay a fairer share of costs based on their actual energy usage while maintaining the financial stability of energy suppliers and their supporting infrastructure.

| Price Cap Component | Description | Where do these costs currently fall? |
|---|---|---|
| **DF (Direct Fuel)** | The cost of buying energy directly from the wholesale market. | Unit rates |
| **CM (Capacity Market)** | Costs associated with ensuring there is enough assured capacity to meet demand, particularly during peak times. | Unit rates |
| **AA (Adjustment Allowance)** | Temporary cost adjustments to account for unexpected changes in the cost of supplying energy. | Unit rates |
| **PC (Policy Costs):** | Costs related to government social and environmental schemes, such as the Energy Company Obligation. | Standing charge and unit rates |
| **NC (Network Costs):** | Cost of building, maintaining, and operating the network of pipes and wires transporting energy. | Standing charge and unit rates |
| **OC (Operating Costs)** | Business costs for energy suppliers, including customer service and billing. | Standing charge and unit rates |
| **SMNCC (Smart Metering Net Cost Change)** | Costs related to the rollout and maintenance of smart meters. | Standing charge and unit rates |
| **PAAC (Payment Adjustment Allowance Credit):** | Adjustments to ensure different payment methods cost the same to the consumer. | Standing charge |
| **PAP (Payment Adjustment PPM):** | Adjustments specifically for prepayment meter customers. | Standing charge and unit rates |
| **EBIT (Earnings Before Interest and Taxes):** | Allowance for the profit margin energy suppliers are allowed to earn. | Standing charge and unit rates |
| **HAP (Headroom Allowance Price)** | Extra costs are factored in to cover uncertainties and risks. | Standing charge and unit rates |
| **Levilisation (Levelisation):** | Mechanism to ensure that the standing charges for prepayment and direct debit customers are the same. | Standing charge |

***Table 1:*** *Components of the Ofgem Price Cap [1]*



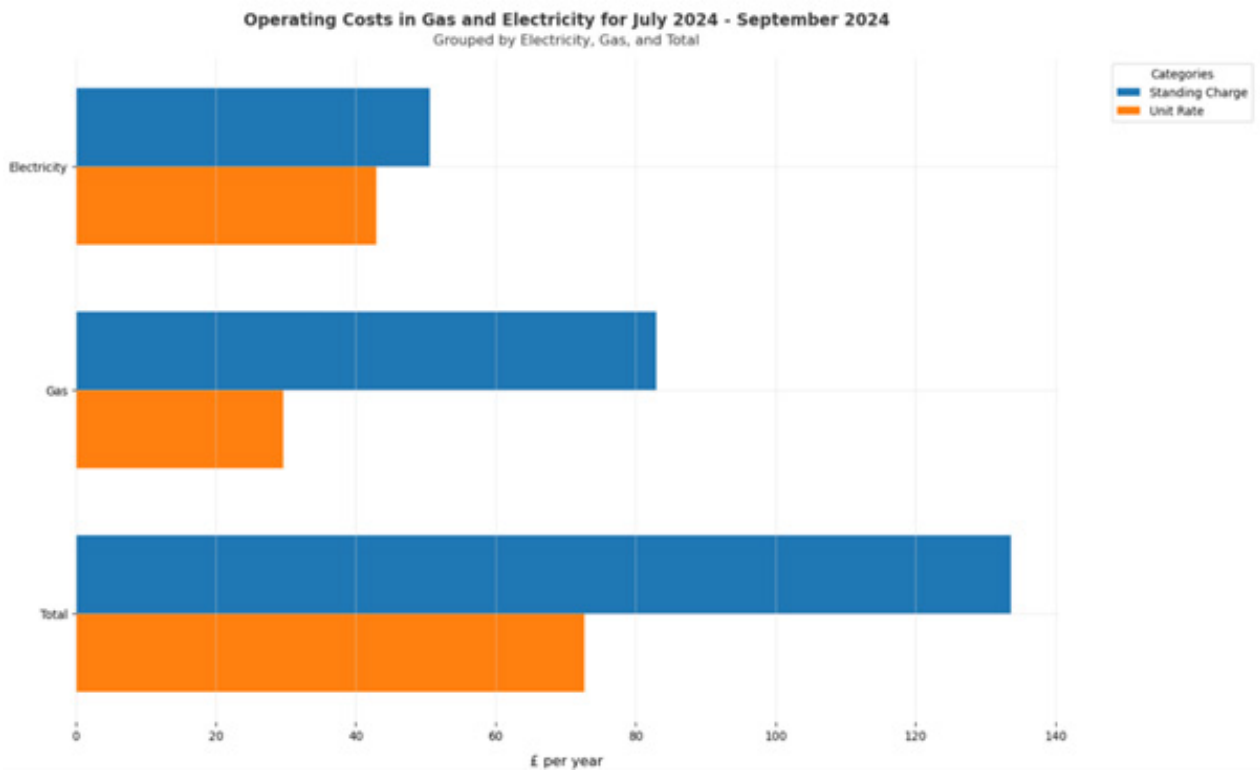

***Graph 3:*** *Cost of each component on the Ofgem Price Cap (Dual Fuel, DDM, TDCV) [1]*

The graph above describes the proportions of each element within the Ofgem price cap, highlighting the distribution of costs between the standing charge and the unit rate. A key finding is that operating costs (OC) have a very large standing charge component, accounting for 64.78% (£133.58) of the total operating costs (£206.19). This indicates that a significant portion of the basic operational expenses of energy suppliers is covered through fixed charges, impacting all consumers equally, regardless of their energy consumption. Similarly, network costs (NC) also have a substantial standing charge component, representing 33.25% (£120.59) of the total network costs (£362.70). High percentages of costs related to smart meter rollout (SMNCC) and payment adjustments (PAAC) are included in the standing charge, with SMNCC at 71.75% and PAAC at 100%.

Additionally, many smaller charges are lumped into the standing charge, such as the headroom allowance price (HAP) and levilisation, the latter being entirely covered by the standing charge. This aggregation can simplify billing, but makes the standing charge harder for consumers to understand. There is potential for redistributing some of these charges to the unit rate, aligning costs more closely with consumption, promoting fairness, and encouraging energy efficiency. This would ensure a fair and transparent pricing structure that better reflects actual energy usage.

## Reevaluating Operating Costs: Unit Rates vs. Standing Charges

**The current structure of energy bills under the Ofgem price cap includes a significant portion of operating costs within the standing charge. This section of the report scrutinises the components driving this distribution and provides recommendations for a fairer allocation. By examining each cost element, we will determine which should be shifted to the unit rate or moved to general taxation, ensuring that consumers pay a more equitable share based on their actual energy usage while maintaining financial stability for energy suppliers.**




***Graph 4:*** *Operating Costs in the Q3 2024 Ofgem Price Cap*

This graph indicates that a significant portion of operating costs is included in the household standing charge. This results in a substantial fixed cost for all consumers, irrespective of their energy consumption. Such an allocation does not seem aligned with the principle that costs should reflect actual usage. By including the majority of operating costs in the standing charge, low-consumption consumers disproportionately bear the financial burden.

Reallocating these operating costs to the unit rate would ensure that costs are more closely tied to consumption. While the aggregation of smaller charges into the standing charge simplifies billing, it results in a disproportionately high fixed cost that can be confusing for consumers. A more equitable distribution of these charges, aligned with actual energy usage, is essential for a fair and transparent pricing structure.

## Breakdown of operating costs

The table below outlines the elements included in operating costs, adapted from Ofgem's 2018 report [2]. These costs encompass metering, central overhead, billing and payment collections, sales and marketing, customer contact, depreciation and amortisation, and industry charges, with recommendations for which should be moved from the standing charge to the unit rate.

| Elements of General Operating Costs (Adapted from Ofgem, 2018) | | |
|---|---|---|
| **Aspect** | **Description** | **% of costs for gas and electricity in 2017** |
| Metering | Meter rental, installation, maintenance and reading (includes smart metering). | Gas 33%, Electricity 27% |
| Central overhead | The fixed costs of an organisation (e.g. office rent, IT, HR, legal). | Gas 19%, Electricity 20% |
| Billing and payment collections | The cost to collect money from customers. | Gas 12%, Electricity 15% |
| Sales and marketing | Advertising and branding, sales activities, third party commissions (including sponsorships and brokerage fees). | Gas 11%, Electricity 11% |
| Customer contact | Operation of call centres or other customer relations. | Gas 12%, Electricity 13% |
| Depreciation and amortisation | Allocation of asset replacement/ wear and tear costs | Gas 8%, Electricity 7% |
| Industry charges | Charges to Elexon, Xoserve, and the smart metering bodies. | Gas 5%, Electricity 7% |

***Table 2:*** *Cost components of Operating Costs[2]*

## Justifications for Shifting Operating Costs to Unit Rate

The table below outlines the elements included in operating costs, adapted from Ofgem's 2018 report [2]. These costs encompass metering, central overhead, billing and payment collections, sales and marketing, customer contact, depreciation and amortisation, and industry charges, with recommendations for which should be moved from the standing charge to the unit rate.

# 01

### Central Overhead

**Proposed Change:** Move to Unit Rate

**Justification:** Central overhead costs, such as office rent, IT, HR, and legal, are fixed organisational expenses that do not vary with the amount of energy consumed. However, by moving these costs to the unit rate, consumers who use more energy will contribute more to these fixed expenses. This allocation method promotes fairness by ensuring that higher consumption correlates with a higher share of the overhead costs. It aligns with the principle of cost reflectiveness, encouraging energy efficiency and ensuring that the costs are spread based on usage.

# 02

### Billing and Payment Collections

**Proposed Change:** Move to Unit Rate

**Justification:** The costs related to billing and payment collections, including issuing bills and managing payment services, are influenced by the number of transactions and the volume of energy billed. Allocating these costs to the unit rate means that consumers who use more energy, and thus generate more billing activity, will bear a greater proportion of these costs. This method aligns the cost burden with the actual service utilisation, promoting a more equitable distribution of expenses.

# 03

### Sales and Marketing

**Proposed Change:** Move to Unit Rate

**Justification:** Sales and marketing expenses, including advertising, branding, and sales activities, are often driven by efforts to attract and retain customers with higher energy consumption. Moving these costs to the unit rate ensures that customers who consume more energy contribute proportionally more to the costs of these activities. This approach also discourages excessive marketing expenditures by aligning them more closely with revenue from energy consumption.

# 04

## Customer Contact

**Proposed Change:** Move to Unit Rate

**Justification:** No evidence found that these costs should be billed at a per household level or a volume based level. Therefore, unless Ofgem presents clear evidence that these costs vary more at a household level then on a volume based level then these costs should be allocated to the unit rate.

# 05

## Depreciation and Amortisation

**Proposed Change:** Move to Unit Rate

**Justification:** Depreciation and amortisation costs related to the replacement and maintenance of infrastructure, property, and equipment are indirectly linked to the volume of energy consumed. By shifting these costs to the unit rate, consumers who use more energy contribute more to the wear and tear on the infrastructure. This method ensures that the costs of maintaining and replacing assets are fairly distributed based on usage.

# 06

## Some/No Change in Allocation

**Metering**

**Justification:** Metering costs, including meter rental, installation, maintenance, and reading (including smart metering), are fundamental to providing energy services and are necessary regardless of the amount of energy consumed. Therefore, it is appropriate to keep some of these costs within the standing charge to ensure that all consumers, regardless of their energy usage, contribute to the basic infrastructure required for energy delivery.

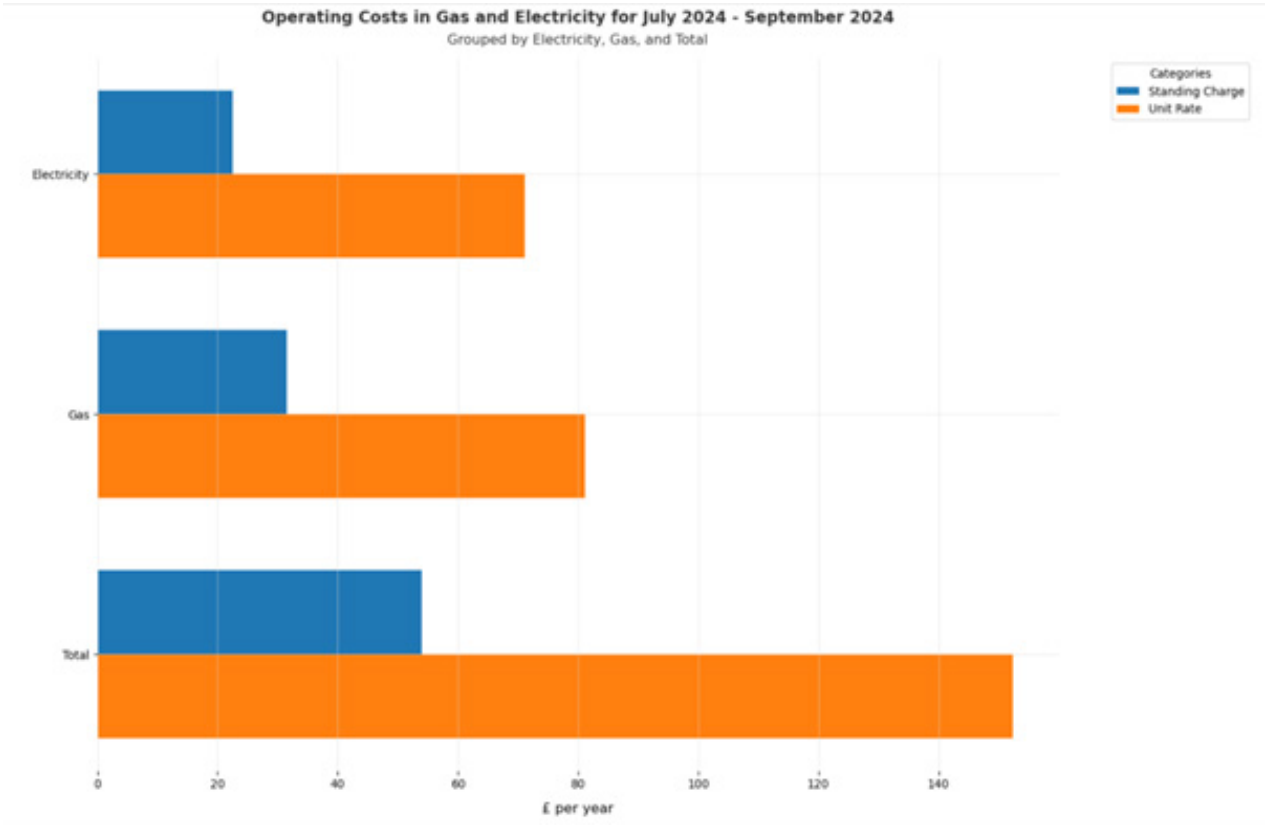
# 07

## Industry Charges

**Justification:** Charges to industry bodies such as Elexon and Xoserve, and the costs associated with the smart metering bodies, are necessary compliance expenses that do not vary with energy consumption. Keeping these charges within the standing charge ensures that all consumers contribute equally to these essential industry costs, maintaining fairness and regulatory compliance.

## Impact of Changes on Total Operating Costs

Reallocating these costs would result in a significant shift in the proportion of operating costs covered by unit rates. Specifically, 72% of the operating costs component for gas and 76% for electricity would be moved to the unit rate.




***Graph 5:*** *Operating Costs in the Q3 2024 Ofgem Price Cap with revised changes*

The standing charge component is expected to decrease from £50.65 to £22.46 for electricity and £82.93 to £31.53 for gas, while the unit rate component increases from £42.93 to £71.12 for electricity and £29.68 to £81.08 for gas respectively. This reallocation implies that 76% of the operating costs for electricity and 72% for gas will be covered by unit rates, ensuring a fairer distribution of costs that better aligns with actual energy consumption.

# Policy Costs and Proposed Changes

## Gas Policy Costs:

| Policy | Amount | Description | Annual Current Household Cost |
|---|---|---|---|
| ECO | £2.99/MWh supplied (UR) | Energy Company Obligation (ECO) supports energy efficiency improvements for low-income households. | £34.38 |
| WHD | £10.91 / customer (SC) | Warm Home Discount (WHD) provides a discount on energy bills for eligible households. | £10.91 |
| GGL | £0.38 / customer (SC) | Gas GHG Levy (GGL) is a levy on gas suppliers to reduce greenhouse gas emissions. | £0.38 |

***Table 3:*** *Components of the Gas Policy Costs [3]*

Impact on bill from removing gas policy costs from the energy bill:

- **Total Standing Charge Difference:** -£11.29
- **Total Unit Rate Difference:** -£34.385

## Electricity Policy Costs:

| Policy | Amount | Description | Annual Current Household Cost |
|---|---|---|---|
| RO | £31.78/MWh supplied (UR) | Renewables Obligation (RO) supports large-scale renewable energy projects. | £85.81 |
| FiT | £7.64/MWh supplied (UR) | Feed-in Tariff (FiT) incentivises small-scale renewable energy generation. | £20.63 |
| ECO | £8.70/MWh supplied (UR) | Energy Company Obligation (ECO) supports energy efficiency improvements for low-income households. | £23.49 |
| WHD | £10.91 /customer (SC) | Warm Home Discount (WHD) provides a discount on energy bills for eligible households. | £10.91 |
| AAHED C | £0.49/MWh supplied (UR) | Assistance for Areas with High Electricity Distribution Costs (AAHEDC) helps reduce costs in remote areas. | £1.32 |

***Table 4:*** *Components of the Electricity Policy Costs [3]*

Impact on bill from removing electricity policy costs from the energy bill:

- **Total Standing Charge Difference:** -£10.91
- **Total Unit Rate Difference:** -£131.247

## Justification for Moving Policy Costs to General Taxation

Moving policy costs to general taxation rather than including them in energy bills can significantly alleviate the financial burden on low-income households. Currently, these costs are embedded in both the standing charge and unit rates, disproportionately impacting those who consume less energy but still face high fixed charges. This approach places a heavier financial strain on vulnerable consumers.

Shifting policy costs to general taxation spreads these expenses across a broader tax base, ensuring a fairer distribution of the financial burden. This method leverages progressive taxation, where higher-income individuals contribute more, thereby reducing the regressive impact of energy policy costs on low-income households. Additionally, by removing these costs from energy bills, the overall energy costs for consumers would decrease, directly addressing fuel poverty and helping to make energy more affordable for everyone. This change is essential for promoting social equity and ensuring that essential energy policy goals, such as supporting renewable energy and assisting low-income households, are funded in a manner that does not exacerbate fuel poverty. The estimated cost to the taxpayer for moving the policy costs from consumer energy bills to general taxation would be ~£5.18 billion per year or £163.3 per income tax payer.

## Shifting EBIT and HAP Onto Unit Rates

**Current Situation:** Currently, 20.59% of EBIT and 16.77% of HAP are included in the standing charge for dual fuel households. Specifically, this translates to pre-tax values of £7.91 for EBIT and £2.71 for HAP. This allocation means that even households with minimal energy consumption are still required to pay a fixed amount for these components, which contributes to higher overall standing charges.

**Proposed Changes:** To create a fairer billing system, we propose shifting the entirety of these costs onto unit rates. This reallocation has several benefits:

01

**Fair Distribution of Costs:** By moving EBIT and HAP to unit rates, costs are more closely aligned with energy usage. Higher consumption would lead to higher contributions to these costs, ensuring that those who use more energy pay a fairer share of the fixed overhead and risk-related expenses.

02

**Incentivizing Energy Efficiency:** With EBIT and HAP included in the unit rate, consumers have a greater incentive to reduce their energy usage, as their bills will directly reflect their consumption levels. This can lead to more energy-efficient behaviours and potentially lower overall energy consumption.

03

**Alleviating Financial Pressure on Low-Consumption Households:** Low-consumption households, which are often low-income or vulnerable consumers, will benefit from lower standing charges. This adjustment reduces the financial burden on those least able to afford high energy bills, helping to mitigate fuel poverty.

## Shifting Adjustment Allowance Onto Unit Rates

**The Adjustment Allowance is a component within the energy price cap designed to account for variations in wholesale energy costs, ensuring that suppliers can recover their actual costs. The Adjustment Allowance should be applied solely to the unit rate rather than being split between the unit rate and the standing charge. This approach ensures greater transparency and aligns costs directly with energy consumption, making the billing process fairer for consumers. Currently, while the value of the Adjustment Allowance is set to zero, it is crucial to avoid placing any part of it on the standing charge without thorough reasoning and due diligence to prevent unjustified fixed costs on consumer bills.**

## Shifting PAAC and PAP Onto Unit Rate

# 01

### Payment Adjustment Allowance Credit (PAAC)

**Current Situation:** The Payment Adjustment Allowance Credit (PAAC) is currently fully included in the standing charge, costing households £8.44 per year. This means that every consumer, regardless of their energy usage, pays a fixed amount for this allowance.

**Justification:** Shifting the entirety of PAAC to the unit rate ensures that the costs associated with payment adjustments are more fairly distributed based on energy consumption. This change would align costs with actual usage, reducing the financial burden on low-consumption households and promoting fairness. By moving PAAC to the unit rate, consumers who use more energy will contribute more to the payment adjustment allowance, which is a more equitable approach.

# 02

### Payment Adjustment PPM (PAP)

**Current Situation:** The Payment Adjustment PPM (PAP) is currently 20.84% included in the standing charge, costing consumers £1.33 per year. The remaining 79.16% is covered by the unit rate.

**Justification:** Shifting the entirety of PAP to the unit rate ensures that all costs associated with prepayment meter adjustments are tied to actual energy consumption rather than a fixed fee. This adjustment promotes fairness by ensuring that higher consumption leads to higher contributions to PAP. Additionally, this change alleviates the financial burden on low-consumption households by reducing the standing charge, thereby providing a more equitable pricing structure.

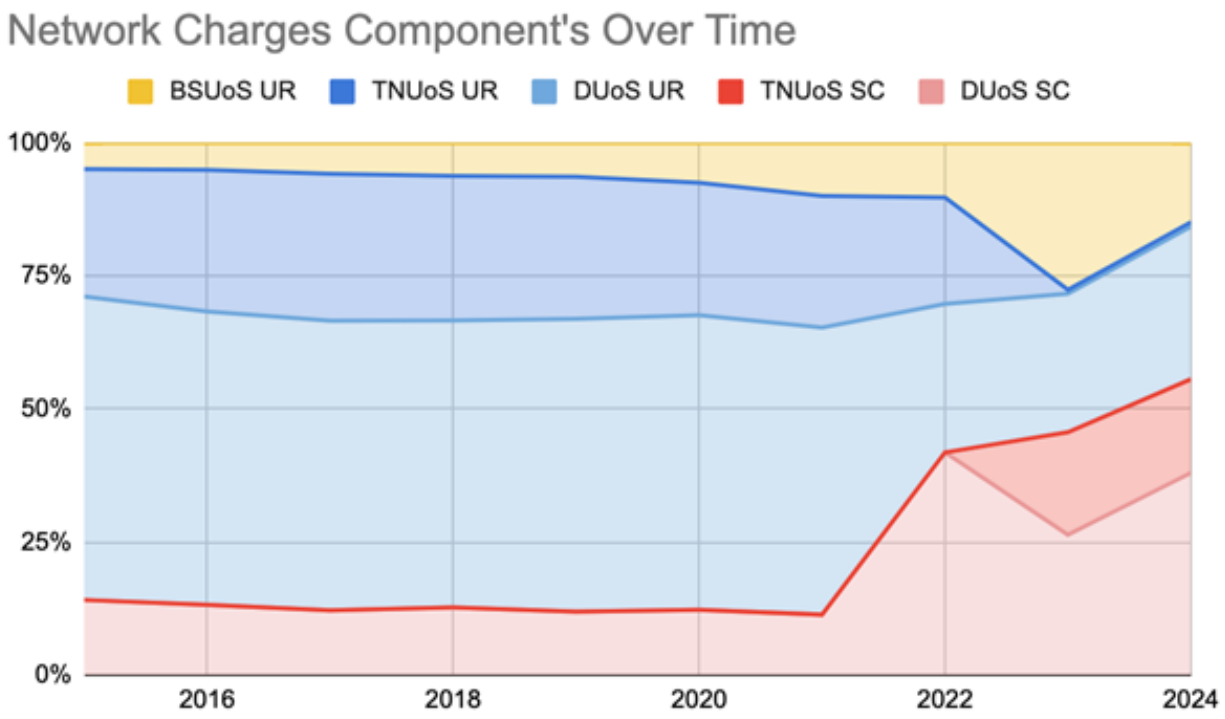
## Network Costs

### Key Findings:

- Network costs have shifted significantly from unit rates to standing charges since 2022. The impact of these changes on vulnerable and low-consuming households should have been more thoroughly investigated.
- The Supplier of Last Resort (SoLR) costs should be moved to general taxation.
- Due to the substantial profits and dividends paid by the network companies, we have added a 10% reduction to the standing charge.
- Gas and electricity charge methodologies should be reviewed and aligned.

## Electricity:

For electricity, the network costs are composed of the DUoS, TNUoS and BSUoS (Distribution, Transmission Network, and Balance Service Use of System respectively). DUoS and TNUoS are captured in both the standing charge and the unit rates but their allocation in each has varied over time. Standing charges made up 13% of network charges in 2021 and have since increased to 61% for the current price cap period of July- September 2024. Between 2015 and 2021, network standing charges were entirely driven by the DUoS component, but since then standing charges have increased dramatically and from 2023 the majority of the TNUoS charges were moved to the standing charges component.




***Graph 6:*** *Network Charges moving from unit rates to standing charges [4]*

Both distribution and transmission charges are regulated by the Ofgem price control every five years. For distribution charges, the next five year cycle began in April 2023, while the transmission price control is set from 2021 to 2026.

| | DUoS | TNUoS | BSUoS |
|---|---|---|---|
| Standing Charge | 82.41 | 38.17 | - |
| Unit Rate | 54.16 | 1.54 | 22.74 |
| TOTAL COST | 136.57 | 39.71 | 22.74 |

***Table 5:*** *Network Chargers for July-September 2024, £GBP. [4]*

## TNUoS (Transmission costs)

Historically, TNUoS charges consisted of two parts: TNUoS Demand Residual (TDR) and TNUoS Generation Residual (TGR). The TDR was recovered through “triad” charges based on their consumption during the three highest demand half-hour periods in winter.

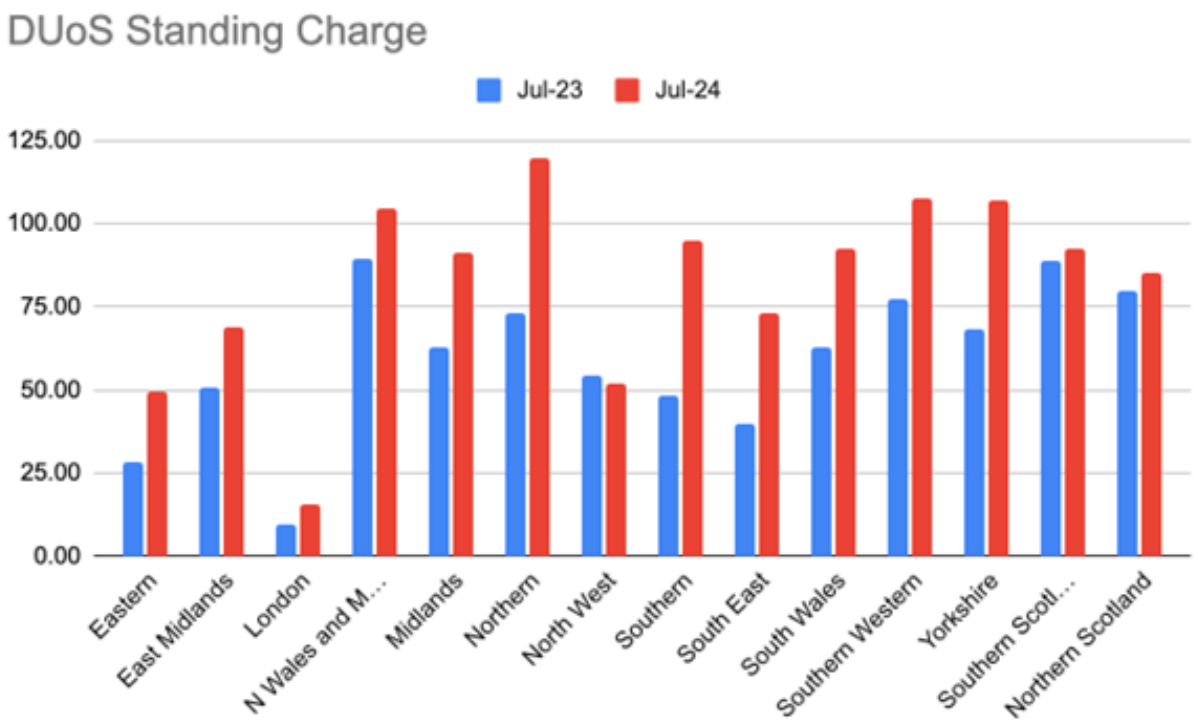
Before April 2023, domestic customers paid for TNUoS through the unit rate of electricity. During the period from October 2022 to March 2023, domestic TNUoS costs varied across regions by over 135%, with a maximum of £51.96 and a minimum of £22.00.

Ofgem undertook the Targeted Charging Review (TCR) with the aim of creating a level playing field and making charges fair for all users. The TGR was set to £0, and the demand charges for domestic customers were split into two parts. The Non-Locational Demand Residual banded charge forms the standing charge component and is the same for all customers across the country. The demand tariff is the unit charge of the TNUoS, rated in p/kWh at the Grid Supply Point (GSP), and is 3.9% of the TNUoS charge for 2024.

## DUoS (Distribution costs)

The DUoS standing charge component has increased more than seven times since 2020, from £17.27 in April 2020 to £82.41 in April 2024, with the proportion rising from less than 20% prior to April 2022, to around 60%.

Each DNO region charges a different amount for connecting to the grid. The disparity is vast. London has the lowest standing charge at £15.62 in July 2024 and the South Western region pays the highest at £107.38. The standing charge increase year to year also varies significantly by region. All but North West saw an increase in standing charge compared to last year. Some regions like Southern nearly doubled their DUoS standing charge compared to last year whereas North West decreased by 4.4%




***Graph 7:*** *Network Charges moving from unit rates to standing charges [4]*

The Supplier of Last Resort (SoLR) costs were added to the DUoS standing charge in Winter 2021/2022. SoLR costs are those faced by suppliers who have taken on customers from the many smaller suppliers that have gone out of business and are paid for by the bill payer. When introduced, SoLR costs were over £65 per year but have since decreased significantly.

## Gas:

There are no network costs covered by the standing charge for gas; all are currently covered by unit rate charges. The gas network demonstrates a model that removes all network charges from the standing charges. Different methodologies for gas and electricity network costs make the comparison between the two energy types complex: for gas, this approach simplifies the billing process and ensures that consumers only pay for what they use. However, for electricity, the inclusion of network costs in standing charges can lead to higher fixed costs for consumers, regardless of their usage levels. This discrepancy highlights the need for a more uniform approach to network cost allocation across different energy types to ensure fairness and transparency for all consumers.

## Network Charges Proposed Change

The shift of TNUoS costs from unit rates to standing charges has eliminated regional variations, which is a positive development as it prevents domestic customers from being unfairly penalised for their location. However, we believe that allocating over 90% of the TNUoS to the standing charge is not a fair distribution for households with low consumption.

Similarly, for DNUoS, we recommend that the majority of the charges should revert to being covered by the unit charge, as was the case prior to 2022. The current weighting of 60% on the standing charge, compared to 20% prior to 2022, represents a significant shift.

The SoLR charge is not a component of network charges, and should therefore be moved to general taxation as it represents a social obligation that benefits the public as a whole, ensuring that all consumers have continuous access to electricity even if their supplier fails. Moving this charge to general taxation would distribute the financial burden more equitably across the entire population, rather than disproportionately affecting electricity consumers, particularly those with lower usage who are more impacted by fixed charges.

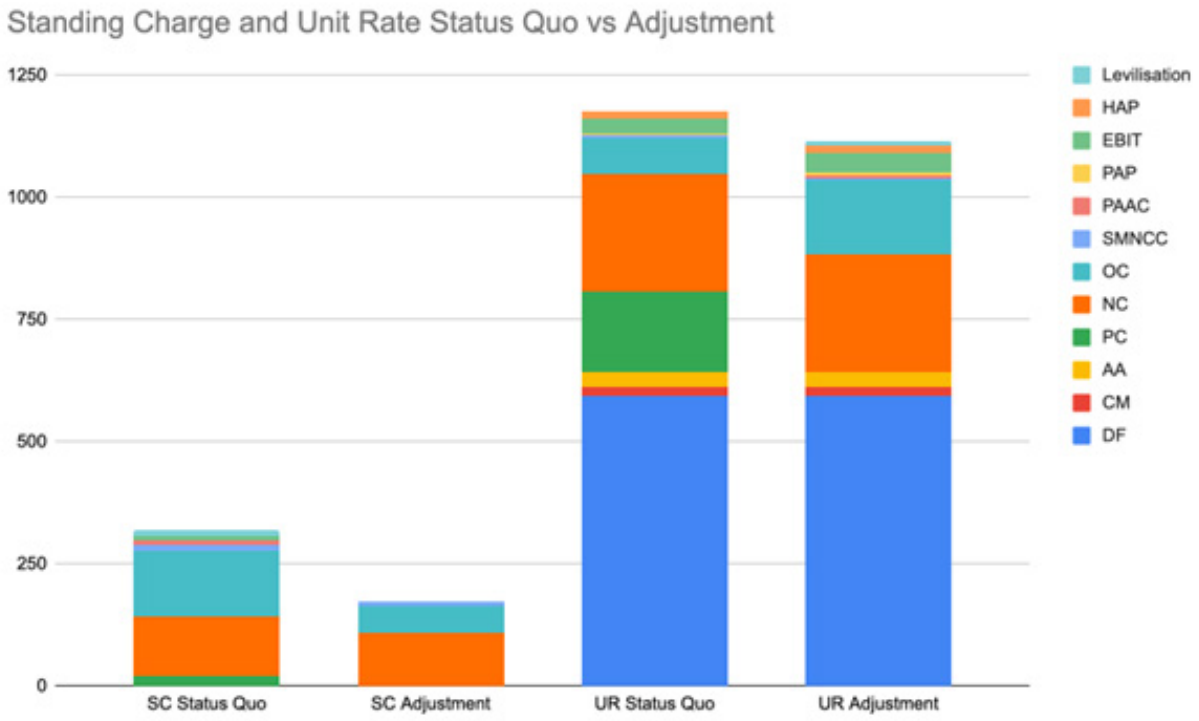
Network owner and management companies pay out dividends unusually high for a sector so heavily regulated: dividend payments from the major Distribution Network Operators (DNOs) totalled £3.6 billion from 2017 to 2021, while gas distribution companies paid out £2.4 billion over the same period. Distribute these figures across 28 million households and the annual bills would reduce by £32 for electricity and £21 for gas. In 2021 this would cover the full standing charge on network costs for electricity. Similarly, in 2022, electricity distribution companies led the profitability rankings, recording a profit margin of 42.5%, surpassing even private equity and tech giants [5].

As an example, for the fiscal year 2022/2023, UK Power Networks (UKPN) reported over £660 million in profit after tax and £123 million in operating cash flow at the end of the year. If this profit were distributed across the 8.3 million households within their network jurisdiction, the bill reduction would range between £14.80 and £79.50 per household.

We believe that network companies should face stricter regulations regarding the dividends they pay their shareholders and the profits they are allowed to accumulate. This is crucial to ensure that households are not unfairly burdened with excessive costs while these companies continue to generate substantial profits.

# Fixing the Ofgem Price Cap - What Could Energy Bills Look Like?

The proposed changes to the Ofgem price cap aim to create a more equitable distribution of energy costs by shifting certain components from the standing charge to the unit rate or to general taxation. The chart below compares the current and proposed structures of energy bills.




***Graph 8:*** *Impact on final energy bills with proposed changes. (Each component given is excluding VAT)*

It can be seen that the majority of operating costs are currently included in the household standing charge. This results in a substantial fixed cost for all consumers, regardless of their energy consumption. Such an allocation is not aligned with the principle that costs should reflect actual usage. By including the majority of operating costs in the standing charge, low-consumption households disproportionately bear the financial burden.

## Key Points:

- **Operating Costs (OC):** Currently, 64.78% of OC is included in the standing charge, costing households £133.58 per year. The proposed changes would reduce this to £53.99, moving the remainder to the unit rate.
- **Policy Costs (PC):** Shifting policy costs from both standing charge and unit rates to general taxation would alleviate the burden on low-income households and ensure a more equitable distribution.
- **Earnings Before Interest and Taxes (EBIT) and Headroom Allowance Price (HAP):** Shifting EBIT and HAP entirely to the unit rate aligns costs more closely with energy usage, reducing the standing charge by £7.91 and £2.71, respectively.
- **Payment Adjustment Allowance Credit (PAAC) and Payment Adjustment PPM (PAP):** Currently, 100% of PAAC and 20.84% of PAP are included in the standing charge. Moving these to the unit rate would ensure a fairer distribution of costs based on actual energy consumption.

Overall, the proposed changes would reduce the total standing charge from £334.08 to £183.02, and decrease the annualised unit rate component cost from £1233.87 to £1170.72, ensuring a fairer distribution of costs that better aligns with actual energy consumption. Overall this would see total energy bills for an average consumption dual fuel household fall from £1567.96 to £1353.74, with greater impacts being felt on those with lower consumption. Resolving the standing charge dilemma will have dual benefits: reducing bills now and helping people in debt. Lowering standing charges reduces the fixed portion of bills, allowing those already in debt to allocate more of their payments towards reducing their outstanding balances. This approach will address the role standing charges play in trapping people in debt and potentially reduce fuel poverty levels to those seen before the energy cost crisis.

This approach promotes both fairness and energy efficiency, reducing the financial burden on low-consumption households and providing a more equitable pricing structure. Ofgem noted in their 'standing charges: call for input' [6] that lower standing charges might not aid low-income households with high electricity needs due to medical conditions. However, this report advocates for government support and taxation to cover the energy bills of those with critical medical conditions. Additionally, shifting policy costs from energy bills to general taxation would predominantly lower electricity costs, benefiting high electricity consumption households.

| All figures quoted in PENCE | 1 July 2024 (Ofgem price cap) (pence) | 1 July 2024 (proposed new model) | 1 Oct 2024 (CI prediction) | 1 Oct 2024 (proposed new model based on CI) |
|---|---|---|---|---|
| Gas unit rate (kwh) | 5.48 | 5.73 | 6.29 | 6.58 |
| Gas standing charge (day) | 31.41 | 9.27 | 33.00 | 9.74 |
| Electricity unit rate (kwh) | 22.36 | 18.97 | 25.77 | 21.86 |
| Electricity standing charge (day) | 60.12 | 40.87 | 61.00 | 41.45 |

***Table 6:*** *Comparison of Energy Rates and Standing Charges under proposed changes*

# Bibliography:

[1] Ofgem. (2024). Energy Price Cap - Default Tariff Policy. Retrieved from Ofgem

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[4] Ofgem. (2023). Network Cost Allowance Methodology Electricity (Annex 3). Retrieved from Ofgem

[5] Baines, J., & Hager, S. B. (2022). *Profiting Amid the Energy Crisis: The Distribution Networks at the Heart of the UK's Gas and Electricity System*. Common Wealth. Retrieved from http://common-wealth.co.uk

[6] Ofgem. (2023). *Standing Charges*: Call for Input. Retrieved from Ofgem's website.

# Appendix:

**Supporting Documents**

**Spreadsheet: Analysis of Proposed Changes to Standing Charges**

For detailed calculations and further analysis related to the proposed changes in standing charges, please refer to the following spreadsheet:

Analysis of Proposed Changes to Standing Charges