

Daniel Norton  
Deputy Director, Price Cap  
Ofgem  
10 South Colonnade  
Canary Wharf  
London E14 4PU

20<sup>th</sup> September 2024

Dear Daniel,

**Re: Call for input on Standing charges: domestic retail options.**

I am writing on behalf of National Grid Electricity Distribution (South Wales) plc, National Grid Electricity Distribution (South West) plc, National Grid Electricity Distribution (East Midlands) plc and National Grid Electricity Distribution (West Midlands) plc, collectively known as “NGED”, in response to Ofgem’s call for input on Standing charges: domestic retail options.

NGED welcomes the opportunity to provide its responses to the relevant questions set out in the options paper published 23<sup>rd</sup> August 2024. Please find our responses set out below.

Question 1: Do you have any views on our case for change?

**NGED Response:**

DNOs receive a lot of customer queries regarding standing charges and these come from both Domestic and Non-Domestic Customers. The DUoS part is usually a significant proportion of the consumer’s total fixed charge from the supplier. From the queries that NGED have received these seem to be directly passed onto consumers. Our customer feedback is that these seem unpopular to non-domestic customers.

Question 2: What are your views on the range (£20-£100) of operating costs we are considering shifting from standing charges to unit rates? Should it be higher? Within this range, is there a value you would favour and why?

**NGED Response:**

See answer to question 9 and appendix 1.

Question 3: What are your views on the trade-offs and impacts we have identified for consumers and suppliers? Should any of these take more or less significance in our assessment, and are there any important impacts we have not considered?

NGED Response:

If the reduction in standing charges is going to be applied through the price cap without changes to network charges, then low usage customers may struggle to find suppliers as the supplier may have to take the hit on the fixed costs from Networks. The other option left open to suppliers would be raise the unit costs for low usage customers so the customer ends up paying the same.

Question 4: What are the changes required, if any, to the price cap to facilitate a reduction in the level of the operating costs charged through the standing charge?

NGED Response:

Not a DNO question.

Question 5: Could mandating suppliers to have at least one low or no standing charge tariff available to customers help promote competition in this area of the market?

NGED Response:

Not a DNO question.

Question 6: How could we create flexibility in how costs are recovered between the unit rate and standing charge without reducing the protection provided by the cap?

NGED Response:

Not a DNO question.

Question 7: In enabling greater diversity in standing charges on default tariffs, what, if any, safeguards would be needed to protect vulnerable consumers?

NGED Response:

Not a DNO question.

Question 8: What are the key considerations we should take into account in developing options for smoothing spend for prepayment meter customers?

NGED Response:

Not a DNO question.

Question 9: Do you have any views on our considerations for the allocation of network and policy costs?

NGED Response:

A lot of the network costs are essentially fixed costs. These are assets that don't change significantly year on year. Therefore, it is cost reflective to recover these costs on a fixed basis. The DUoS network costs are a small proportion of the total supplier charge. The DUoS network charge for NGED is typically less than £110 per year.

The TCR direction was very clear to DNOs and has been implemented through the DCUSA process as directed. However, there are several parts of this that seem unfair to customers. For example, there is the cliff edge banding where a customer with 1kva more can be charged a significantly larger amount.

Customers are banded using a two-year average and they remain in the same band for 5 years. This means it is very difficult for them to reduce their costs despite reducing capacity and contributing to a reduction in reinforcement on the network. Domestic prices are charged the same regardless of their size meaning a small 2 bedroom is charged the same as a 5 bedroom despite both properties having very different average and maximum usage.

If the TCR is to be retained please see below in Appendix 1 suggestions for improvements. These proposals focus on cost reflectivity and all users making a fair contribution to the fixed costs of the network. Essentially it considers capacity to be the cost driver of the network. We would also note that there will inevitably be distributional impacts resulting from these changes and these could be mitigated by social tariffs for example. National Grid supports a social tariff as a tool for managing any negative distributional impacts that may arise from introducing more capacity-based DUoS charges.

Should you have any queries in relation to our response, particularly with regards to our proposal set out in response to question 9, and expanded upon within Appendix 1, please do not hesitate to contact me.

Yours sincerely



Simon Yeo  
Income Manager  
National Grid Electricity Distribution

### DUoS Charges – Residual Component

#### Background

DUoS charges are made of two components;

Firstly; there is the forward-looking charge. This is determined by looking at asset costs, load characteristics and probabilities of time of DNO system peaks. The aim of this component is to influence customer behaviour by sending price signals of when to consume.

Secondly; taking the charges from above and multiplying by all the forecast load data, MPAN numbers and kVA capacity – a forecast income can be calculated. This forecast income will not equal DNO allowed income. The difference between the two is known as the Residual income and this is the second component of DUoS charges.

This paper looks at options of how to allocate residual income to end users.

#### History

The residual can be expressed as a p/kWh fixed adder by taking the £m residual and dividing by kWh.

When the CDCM (Common Distribution Charging Methodology) was introduced in 2010 this p/kWh fixed adder was applied to only the RED unit rate i.e., the peak rate. Subsequently, the method went through the change process and it was applied to all unit rates (R A G). This was the case until the end of the 21/22 regulatory year.

### OPTIONS

#### 1. Current Method of Residual Allocation

The Targeted Charging Review (TCR) completed by Ofgem in December 2019, introduced a method whereby the residual was recovered by additional p/MPAN/day charges i.e., a fixed charge. This varies across different tariffs and bandings within tariffs in line with the kWh in each of those tariffs.

If we think of the residual charge as being the recovery of past investments decisions (i.e., not the forward-looking component) then the residual is in effect recovering the cost of the existing network.

On that basis it seems reasonable that all customers should be charged to pay for the existence of the network regardless of whether they use it or not i.e., a TopUp and Standby charge.

The problem that exists is that in the main end customers often don't like fixed charges and don't see them as fair, as customers cannot look to take action to manage their exposure to them. This issue has been exacerbated in the non-domestic tariffs by introducing different bands within the tariffs such that bigger users and bigger capacity customers pay more. But as ever with bandings there are cliff edges and in addition customers cannot leave the band, they have been assigned to for a five-year period unless there are extraordinary circumstances.

## **2. New Method**

Ahead of Ofgem formally commencing its charging review (DUoS SCR) the NGED Income team are considering options/alternatives they could propose. A different method could be as follows.

The first principle is again that everyone should contribute to the network existing that would seem to be fair to all users. The second principle is that charges should align more closely to what drives actual DNO cost, which in the main is the capacity of the network.

Taking these principles, the aim is then to allocate income to be recovered from the residual charge to different tariffs based on their capacity. This is not an easy task as the data is not necessarily readily available. But the NGED teams using latest data analytics and modelling could hopefully consider.

Domestic customers; there are too many customers to have individual capacities in a billing system. Therefore, they need to be grouped in some way. At present there are implicit capacities based on fuse sizes going into a house but these tend to be broadly the same for most households.

Something else is required. Council tax bands could be used but these take no account of capacity used and are perhaps out of date. Another dataset is required that allows a differentiation between house size, type and what capacity requirements that house would have over and above the norm. For example, does it have an EV charger? At this stage that dataset is not known but from smart meter half hourly data a picture can start to be built up where kW usage can be determined and this along with what the DNO knows about connection arrangements such as does an EV charger exist, can start to build up more knowledge of the characteristics of individual homes which can then be used to group households into usage bands (not ideal having bands but these can be re-assessed regularly. This could provide a basis to charge the residual charge component based on deemed capacity for domestic customers.

For business half hourly metered (HHM) capacity of individual customers is known through the connection agreement and so this customer set can be charged accordingly in line with capacity. For business non-half hourly metered (NHH), as with the domestic market this is more difficult to determine the individual capacity as with the domestic market unless a connection agreement exists. However, some of these customers will have smart meters and so kW data can be determined which again means notional/deemed capacity can be assigned. There may be a subset of customers for whom individual kW data doesn't exist and so a different method would be needed which could for example take on aggregate monthly/yearly consumption data.

### **Summary**

Residual income could be charged out on a capacity basis rather the current fixed charge basis. This would be a combination of actual capacity known through connection agreements for business customers and a deemed approach for domestic customers (and some non-domestic) based on characteristics of the individual customers.

Next steps would be to do a preliminary impact assessment to determine how much capacity is in the two segments, domestic and non-domestic, this would provide an insight into the potential price disturbance. The income team could undertake this work with some high-level working assumptions possibly by the end of April.

## Notes

1. RED AMBER GREEN Unit (kWh) rates
  - a. RED time bands are specific to each DNO area. They tend to be one the peak MW demand on the system occurs. So, for example in the South West region they are weekdays between 5pm and 7pm. The prices in this time band reflect the higher demand and are the highest of the unit rates.
  - b. GREEN time bands tend to be over night and at weekends i.e., when demand is lower
  - c. AMBER are all other times such as day time on a weekday
2. Example of cliff edge banded prices
  - a. South West area April 24 prices has a band 4 HV annual charge of £191k but for a band 3 customer it is £76k p.a. The boundary between the two bands is set at 1800kVA of MIC