

Discussion Paper

Standing Charges: Call for Input

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Contact:	James Crump
Team:	Retail Directorate
Telephone:	020 7901 1000
Email:	StandingCharges@ofgem.gov.uk

We are inviting stakeholder views on standing charges. We particularly welcome responses from suppliers, consumer groups and charities. We would also welcome responses from other stakeholders and the public.

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Foreword

We are now entering the third winter since the energy crisis and many consumers continue to struggle with high energy prices. The main driver of high energy bills in the last two years has been the price of energy on wholesale markets, which has fed through into unit rates. But standing charges have also been rising and are a particular burden for some consumers. We recognise how hard it is for many consumers, who are striving to make higher energy prices fit in their budgets, to pay regardless of how much energy they use. Consumers who have made sacrifices to save energy, or who have invested in energy efficiency measures, have still seen standing charges go up in their bills.

The costs that feed into standing charges are a part of the enduring costs of the energy system. They cover fixed operational costs of serving each customer, and fund important network build, upgrade and maintenance costs that are necessary to keep all consumers connected and to drive progress towards net zero targets. These costs need to be met and will ultimately fall in some way to all billpayers. We cannot, as the regulator, make these costs go away but we can affect how they are recovered from customers.

While we do not set standing charges, our regulations affect and influence the way suppliers recover the costs they need to pay for each customer on supply. We need to look again at how the way we regulate the market affects the prices charged. As a first step, we are changing the rules for suppliers on how they charge those who pay by different payment methods and reducing the standing charges for those who pay by prepayment meters and standard credit. But Ofgem's last in-depth review of standing charges was prior to the energy crisis and the time has come to re-open this debate and consider whether standing charges are set in the right way and are fair between different types of consumers.

This discussion paper sets the scene for the work that we will be undertaking throughout winter, and our engagement with stakeholders such as consumer representatives, charities, suppliers, and network companies to understand their views and to help us develop options. It also sets out some of the difficult trade-offs that will need to be made in any changes in the way these costs are spread between different customers. The evidence we gather through responses to this paper will be instrumental in helping us determine whether and how we might change our approach to standing charges in consumers' best interests. I look forward to working with all stakeholders to make this happen.

Tim Jarvis

Director General, Markets

Executive Summary

What are standing charges?

Standing charges are the fixed component of customers' energy bills. They have been a feature of customer bills since as long as there has been a retail energy market and are a common feature of other sectors too. Broadly speaking, standing charges consist of those costs that it is more efficient to pay on a fixed (per customer or per site) basis rather than per unit of energy consumed.

Standing charges have a legitimate role to play in the retail energy market. They help industry recover the fixed operational costs of serving each customer, and fund important network build, upgrade and maintenance costs that are necessary to keep all consumers connected and to drive progress towards net zero targets. These costs cannot be avoided; they must be paid for somehow, but there are choices in exactly how these costs are recovered.

Why have standing charges gone up in electricity?

Standing charges for domestic electricity customers have increased significantly since 2021. For a customer who pays for their electricity bills by direct debit, they have more than doubled from £86 per annum to £186 per annum on average between 2021 and 2023.

The reason for this increase in electricity standard charges is that suppliers are now having to pay more fixed costs and are passing them on to customers in the form of standing charges rather than a unit cost basis.

The first of these costs is some types of network costs (the costs of the infrastructure for getting electricity to customers' homes and businesses). In 2019, Ofgem took the decision to move charging of certain types of network costs from a unit cost basis to a fixed basis (known as the Targeted Charging Review or TCR), which came into effect in 2022 and 2023. The main reason for this change was that charging on a volumetric basis made it too easy for some users to avoid network costs. The TCR was necessary to future-proof the GB electricity network and to ensure that it is properly ready for flexibility and net zero, and it has made the network more efficient, reducing the overall cost for customers. Whilst these measures will have removed the cost of network charges from (and therefore reduced) unit costs, the wholesale energy crisis means that the effect of this has not been obvious to consumers.

The second reason is that the costs of supplier failures in electricity (the costs of appointing Suppliers of Last Resort or SoLR) are recovered from suppliers through

network costs, which in turn is recovered from suppliers as a fixed cost. We expect that the level of supplier failures that we saw in 2021 and 2022 will be a one-off, in part due to the measures that we have taken to strengthen the retail energy industry.

Suppliers have passed these costs on to their customers through standing charges rather than unit rates. It is important to note that these charges would need to be met somehow and would be borne by customers through unit rates if not through standing charges. However, we recognise that standing charges are a particular burden for some consumers.

In gas, network costs and SoLR costs are passed to customers through unit rates. We have not seen the same urgent need for change in the gas sector that prompted the TCR in electricity. As a result, gas standing charges have remained broadly static in real terms.

Regulation, cost recovery, and standing charges

Suppliers are not obliged to pass these fixed costs on to customers through their standing charge (as opposed to a unit rate), but they are able to do so under Ofgem's rules. In practice, all suppliers have chosen to pass on their costs to customers using standing charges and setting those standing charges at a similar level. This level for domestic customers is that allowed by Ofgem's price cap.

There is no 'Ofgem standing charge'

We do not consider that there is any regulatory barrier to suppliers producing tariff products that incorporate network costs into unit rates. Suppliers are not obligated to pass fixed costs on to customers through a standing charge, but only a tiny minority of suppliers do offer a zero standing -charge tariff. Some suppliers have indicated that they would like to see an end to the price cap; there is nothing stopping them from producing a product with a zero standing charge and offering it to their customers, but we note they would need to ensure they are recovering the costs of serving each customer.

However, in practical terms there is very little variety in the tariffs that suppliers offer in the domestic market. We would like suppliers to make a more varied offer to their customers, and we want to understand what is stopping them from doing so.

Is there a fairer way of allocating these costs between different groups of customers?

The effect of increasing standing charges falls disproportionately on customers who are lower down the income distribution, and customers who consume less energy have seen

a greater proportionate impact on their bills. This has caused considerable concern amongst stakeholders.

Some have called for radical action, including the abolition of standing charges altogether. Our analysis in this paper shows that broad-based measures to change standing charges will have complex effects. Amongst households with the lowest incomes, whilst five million households would benefit from a measure to shift electricity costs from standing to volumetric charges, one million would lose out. Those million households that would lose out would include some vulnerable customers with high energy needs, like those reliant on medical equipment or electric heating to keep warm, customers who are reliant on electric heating, and those with poorly insulated homes (often private renters or in rural areas). And whilst the overall effect would be progressive (lower-income consumers would benefit more from a shift back to volumetric costs), those lower-income households that would lose out would see an increase in their bills by twice as much as gainers would see their bills fall.

Our analysis makes it clear that there are no easy answers. Blanket measures, like a market-wide abolition of standing charges, risk harming some consumers – including some of the poorest and most vulnerable. Any measure we take needs to ensure that we are able to target those who have complex needs and benefit from paying a fixed rate for some of their energy bill.

What will happen next?

This Call for Input is the first part of a conversation between us and our stakeholders to understand how we can minimise the impact of increases in standing charges and whether we need to make changes. We intend that it will prepare the ground for further work to make sure that we are doing all we can to protect those who need it from the adverse impacts of those rises. However, it will also help us to ensure that any intervention minimises the risk of unforeseen impacts on consumers. But this is a problem for the whole industry to solve. We want all stakeholders to work together to bring genuine tariff choice back to the market so that all customers can find a product that meets their needs.

1. Introduction

What is this discussion paper for?

- 1.1 Numerous stakeholders, including consumers, consumer representatives, media stakeholders and suppliers have raised concerns regarding the impact of the growth of standing charges in recent months. These concerns were echoed by the Energy Security and Net Zero Committee on 13 September 2023 who called for a replacement of the domestic standing charge model with a rising block tariff, increased transparency on standing charge elements, and a reduction in standing charges.
- 1.2 We recognise the impact that increasing standing charges will have on some customers, and in particular that adding fixed costs to customers' bills may disproportionately impact those on lower incomes. For this reason, we have decided to undertake a programme of stakeholder engagement to ensure that we are doing all we can to minimise these negative impacts on customers.
- 1.3 In this paper we will set out the policy which has led to the changes in standing charges, examine the impact that those changes have had, and attempt to model how changes might affect different types of customer, including non-domestic customers.

Who this document is for

- 1.4 This discussion paper is intended to be read by a general audience, including industry stakeholders, but also consumer representatives and members of the general public. We have tried to explain the issues around standing charges as simply and clearly as possible.

Next Steps

- 1.5 We invite stakeholders' views on any aspect of the issues raised in this paper and in particular on the questions raised. We intend to organise a programme of stakeholder engagement before the response period closes in order to further stimulate debate and understanding of key issues.
- 1.6 Stakeholders' responses to the discussion paper and further engagement will inform any further policy development. Until then, Ofgem will continue to maintain close engagement with the government and actively engage with the energy sector, consumer groups, and other stakeholders.

1.7 Ofgem welcomes your views on the issues raised in this paper. Please send them by 19 January 2024 to: StandingCharges@ofgem.gov.uk.

Section 2: What are standing charges?

1.8 Section 2 of this paper takes a closer look at what standing charges are, the various costs that make up standing charges on a typical electricity bill, and the extent and reasons why these charges have increased.

Section 3: Standing charges, network charges, and the price cap

1.9 In this section, we look at some of the contributing factors to changes in standing charges in recent years. We also look at standing charges in other sectors.

Section 4: How does Ofgem expect standing charges to develop in future?

1.10 Section 4 explains why standing charges may be set to increase and look at the factors that may drive this increase.

Section 5: Standing charges and the domestic retail market

1.11 Section 5 looks at the products available in the domestic retail market, and the extent to which customers have genuine choice between products offering standing charges and those that do not. It looks at rising block tariffs, which some stakeholders have proposed as an alternative model to tariffs with standing charges. Finally, we present an analysis of the potential distributional effects of shifting some or all standing charge costs to the unit rates.

Section 6: Standing charges and the non-domestic retail market

1.12 Section 6 examines the impact of changes in standing charges on the non-domestic retail market.

Section 7: Conclusion

Finally, Section 7 concludes the paper with a call for engagement by stakeholders.

2. What are standing charges?

Section summary

In this section we look at what standing charges are, and what the costs are that contribute to customers' standing charges. We also look at changes in the standing charges borne by domestic retail customers in recent years.

What are standing charges?

- 2.1 Put simply, a standing charge is a fixed amount that customers are required to pay as part of their energy bills, which does not vary according to their energy usage. The standing charge varies by region to reflect the different costs of serving customers in different parts of Great Britain and may also vary slightly between suppliers in the same region.
- 2.2 At present, standing charges are usually calculated on a per day, per site basis. It is calculated separately from a unit charge which will vary depending on the amount of electricity or gas consumed, but usually billed at the same time. Customers will pay standing charges whether they pay for their energy by direct debit, prepayment or standard credit, and whether they have a traditional meter. Whilst it is possible for suppliers to offer tariffs which do not have standing charges, this is uncommon in the domestic retail sector, as we will explore in future chapters.
- 2.3 Standing charges have been a component of energy bills for as long as energy has been supplied to domestic and non-domestic properties, and there has always been concern about their fairness. In a 1982 speech to the House of Commons, John Ward MP reflected views that many consumers still hold in 2023:

"Most people who complain to me about their fuel bills say that, although they economise in the use of fuel, standing charges are an increasing burden. In many instances, the standing charge exceeds the cost of the fuel consumed by a considerable amount.

A constituent who finds electric central heating too expensive to run recently wrote: "A couple of years ago we had a gas fire installed and the standing charge per quarter was £2.16. What logical reason can there be

for increasing standing charges from £8.64 per annum to £36 per annum in two years?"¹

- 2.4 Ultimately, all costs of supplying customers (domestic and non-domestic) in any regulated industry will be recovered from those customers through bills. Some costs of supply are fixed and do not vary with the amount of a commodity that is supplied. In unregulated industries fixed costs of supply will often be absorbed into the price of a product –for example, the cost of a loaf of bread at the supermarket will include a small amount to cover the supermarket’s fixed costs. In other regulated industries fixed costs, and indeed standing charges, are a feature of bills. In energy these costs include network costs (the costs of the gas and electricity ‘grid’, plus services that transmit, ship and balance the energy carried on it), costs of providing assets like meters, plus some administrative costs. Whether a customer consumes no energy or thousands of kilowatt hours per year, the industry will incur these costs just to keep them on supply. We explore these costs further in the next section.

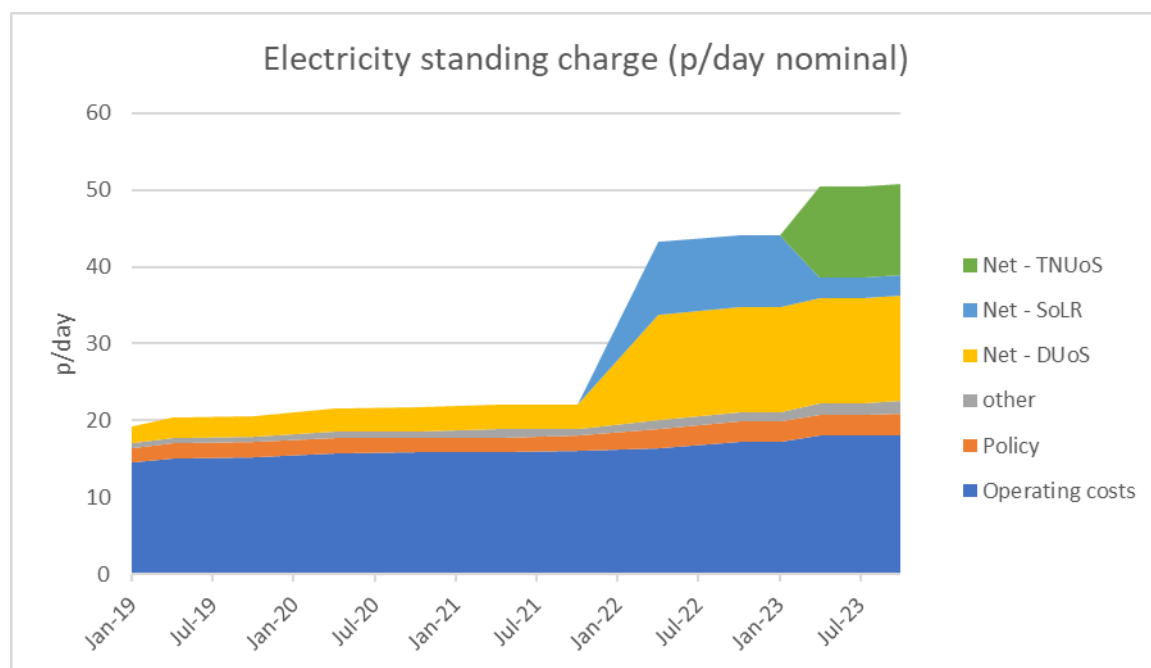
How much have standing charges risen by, and why?

- 2.5 Standing charges in electricity have risen since 2021. Figures 1 and 2 show the changes in the nil consumption level under the Price Cap (as a proxy for the standing charge)² for Direct Debit customers between 2019 and 2023, and the composition of these standing charges.

¹ Domestic Energy Supplies (Standing Charges), HC Deb 13 December 1982 vol 34 cc93-106

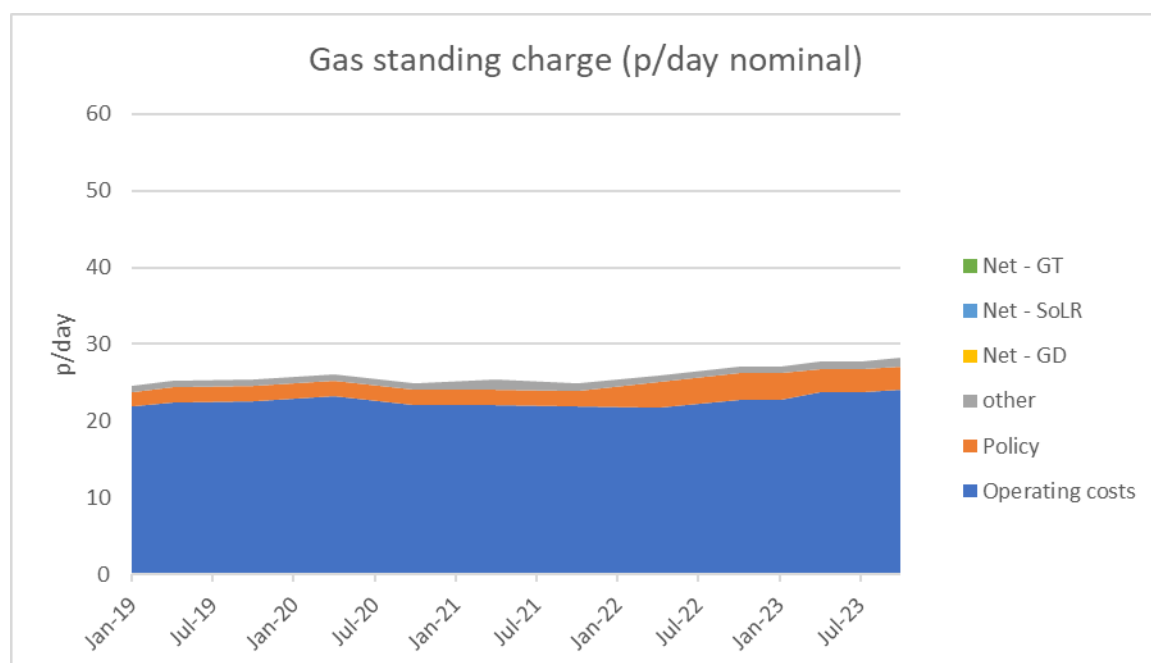
² Figures 1 and 2 show the nil consumption allowance under the price cap. As we will explore in the next chapter, suppliers are able to set a standing charge which is different from the price cap, in practice all suppliers in the domestic market choose to set their standing charge for standard variable tariff at a level which is not significantly different from the nil consumption level. For the purposes of this analysis, therefore, we use this level as a proxy for the standing charge.

Figure 1: Electricity nil consumption (equivalent standing charge) level, Direct Debit customers, 2019-2023 (Source: Ofgem data)



2.6 Nil consumption levels in electricity saw an increase between October 2021 and October 2023, more than doubling from approximately 22p per day (£86 per annum) to approximately 51p per day (£186 per annum).

Figure 2: Gas nil consumption (equivalent standing charge) level, Direct Debit customers, 2019 -2023 (Source: Ofgem data)



- 2.7 Nil consumption levels in gas rose slightly over the same period when measured in nominal terms, from around 25p per day (£91 per annum) to approximately 28p per day (£103 per annum) (which amounts to a slight fall measured in 2023 prices).
- 2.8 The increase in standing charges in electricity from mid-2021 is mainly driven by Supplier of Last Resort (SoLR) costs and a change in the way that network costs are charged to end users (i.e., domestic, and non-domestic customers). These are explained in the next section.
- 2.9 Figures 3 and 4 shows the proportion of the cost of the median energy consumption at the price cap for a direct debit customer taken by standing charges for each price cap period from 2019.

Figure 3: Share of total price cap at median consumption taken by standing charges for electricity direct debit customers, 2019 -2023 (Source: Ofgem)

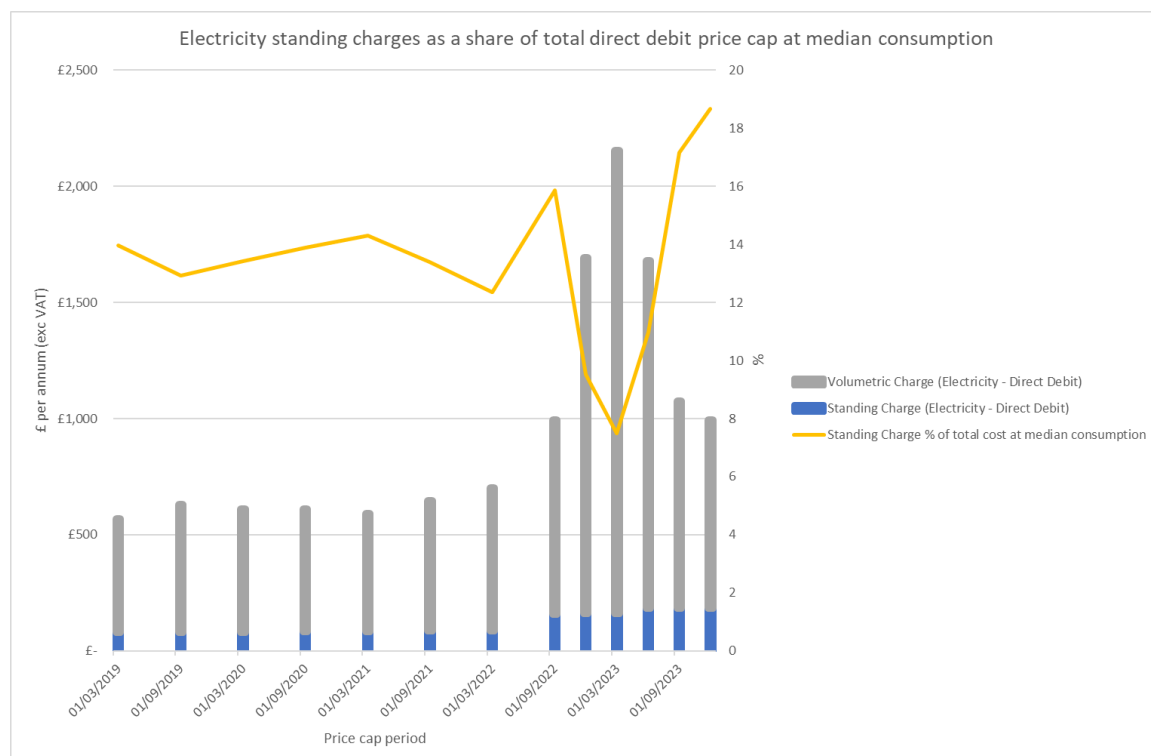
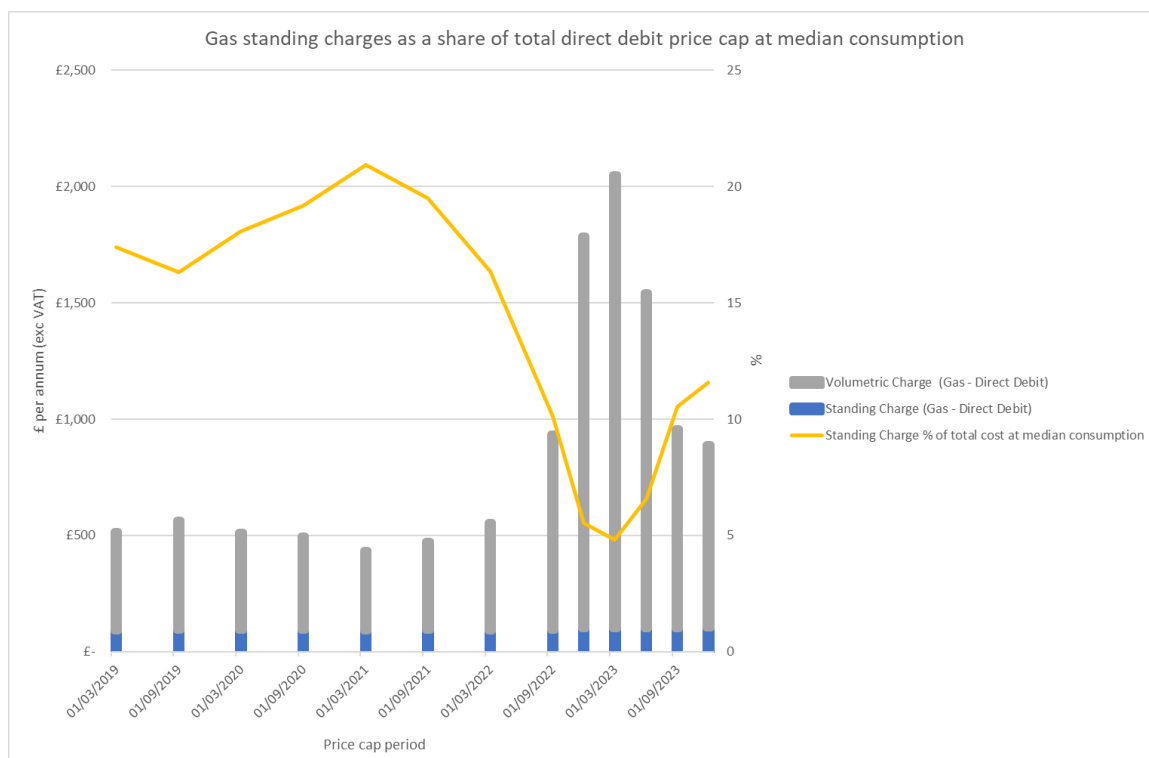


Figure 4: Share of total price cap at median consumption taken by standing charges for gas direct debit customers, 2019 -2023 (Source: Ofgem)



2.10 Figures 3 and 4 show that, whilst standing charges have been increasing in electricity, the impact of this increase on overall cost of energy is much smaller than the impact of increases in wholesale energy costs, which has fed through into unit prices.

3. Standing charges, network charges and the price cap

Section summary

In this section we look at the underlying reasons why standing charges have risen for consumers. We also look at how the domestic retail Price Cap mechanism affects the rate of standing charges paid by consumers.

Questions

Q1: What are the barriers to suppliers using the existing flexibility under the price cap?

Q2: Why are suppliers not innovating on standing charges for tariffs not covered by the price cap?

Q3: What changes could Ofgem make to improve provision for lower standing charges under the cap.?

Q4: As a result of TCR and changes to the recovery of residual costs, domestic consumers with very low consumption now bear a share of fixed network costs which is more in line with the cost of maintaining access to gas and electricity networks. Is this fair? Should more be done to shield these customers from these costs?

Q5: What are the reasons for regional variations in electricity standing charges?

Q6: Can we learn from other sectors about how to improve suppliers' tariff offering in the UK energy market?

3.1 In the previous section we looked at what standing charges are and looked at data that showed that they have risen in the domestic retail electricity market since 2021. The principal reason for the increase in standing charges in electricity is that they include network costs and the costs of supplier failure. In this section we explore these costs and how suppliers pass them on to consumers.

What are network costs and how do they affect what customers pay?

3.2 Network costs represent the costs of moving energy from generation into homes and businesses. End users (customers) will ultimately meet these costs themselves through their energy bills, even if they do not directly pay the network asset owners themselves.

3.3 In electricity, a customer will pay their supplier, who will in turn make a payment to a Distribution Network Operator for use of network services. In gas, a customer will pay their supplier, who will have a contractual relationship with a shipper, who will in turn make payments to a gas network.

- 3.4 Gas and electricity networks are expensive investments with high fixed costs and long asset lives. These networks are, for the most part, natural monopolies where competition from a new entrant with an existing provider usually is not possible. As a result, Ofgem regulates the networks and ensures they cannot abuse their dominant position in the market by limiting how much money they can extract from users.
- 3.5 Ofgem does this using a price control that sets a maximum allowed revenue that can be recovered using network charges. We also set limits on some of the Electricity System Operator (ESO)'s costs they can recover for running the system, which is one of the cost elements that ends up in Balancing Services Use of System (BSUoS) charges. These allowed revenues need to be recovered from users in a consistent way.
- 3.6 Every year, around £11bn needs to be recovered from users to cover the cost of the networks, and system balancing adds a cost of another £4.5bn. These costs need to be recovered from customers ('end users') somehow.
- 3.7 There are different types of network costs which are recovered in different ways. These are summarised below.
- Transmission Network Use of System (TNUoS). This is the cost of installing and maintaining the transmission system³ in England, Wales, Scotland and offshore.
 - Distribution Use of System (DUoS). This is the cost of installing and maintaining local electricity distribution networks.
 - Balancing Services Use of System (BSUoS). This is the cost of the services used on the balancing of power across the entire electricity network, operated by National Grid. Without this balancing system, supply to the grid would not match demand, which would leave the nation at risk of blackouts. These costs are recovered on a volumetric rather than a fixed basis.
- 3.8 In 2019 Ofgem changed the rules regarding how network operators are allowed to recover part of the TNUoS and DUoS costs from suppliers in the electricity market. This process was called the Targeted Charging Review (TCR). This meant

³ The transmission network is the highest-voltage part of the electricity grid and is used to transport bulk power long distances. It links the regional distribution networks, as well as connecting to the Offshore power networks.

that more of the TNUoS and DUoS costs were charged to suppliers on a fixed basis.

'Cost-reflective' and 'residual' charges

- 3.9 Network charges primarily exist to allow network owners to recover allowed revenues (the revenues they are allowed by Ofgem under a price control process). Charges are also used to incentivise users (suppliers, generators and a small number of very large end-users) to use the system efficiently, in order to reduce costs for all end users. These incentives are produced by creating charging models that generate 'cost-reflective' or 'forward-looking' charges. These charges do not usually recover enough money to meet the allowed revenues, and so are supplemented with a top up element called 'residual' charges.
- 3.10 This 'residual' top up is around 25% of the distribution allowed revenue, or £1.7bn per year. On transmission, it is closer to 75%, or almost £3.5bn per year.

Residual costs

- 3.11 Earlier versions of the charging arrangements recovered this 'residual' element from users at peak times. Where these residual costs were added to users' peak costs, they could be avoided if users were able to shift their use out of peak times or replace use of the networks at peak time with use of on-site generation. This behaviour can bring benefits to the system, and where it does, this should be reflected in 'cost-reflective' charges. However, to the extent that users are avoiding the residual parts of the network costs, these will need to be met by someone else.
- 3.12 Ofgem had continuing concerns about transmission residual charges following work in 2016 and 2017 to address major transmission charging distortions broadly known as 'embedded benefits'. The design of these charges meant it was feasible for some users⁴ to pay nothing at all towards the system if they were able to avoid usage in a few key periods. This was unfair on other system users, and was also unsustainable in the long-term, as each year avoidance increased. This made charges for the remaining users more expensive, which in turn meant more users turned to avoiding charges.

⁴ 'Users' in this context means suppliers, generators, and a very small number of high-consuming non-domestic end-users, rather than domestic or non-domestic customers of energy suppliers.

- 3.13 Distribution residual charges were moved from peak units only to all units in April 2018, but still provided some users with an opportunity to avoid network charges while having the option to use the network when desired.

The Targeted Charging Review (TCR)

- 3.14 The Targeted Charging Review (TCR) was Ofgem's attempt to address concerns that some users were avoiding much of the costs of the networks, while others were left picking up a disproportionate share. Following policy development, consultation and debate, we decided that fixed 'per-site' charges would be the most efficient way to recover these funds, across both transmission and distribution. This decision saw around £5bn worth of network charges per annum moved from charges on unit rates or on peak use to charges levied as a daily standing charge across domestic and non-domestic customers. The changes were implemented in 2022 for distribution charges, and 2023 for transmission.
- 3.15 Under the TCR, Ofgem decided to have a single charge for each domestic site. This means that all domestic customers pay the same amount of electricity network costs, regardless of their consumption, energy efficiency or size of property. The final TCR decision⁵ considered whether bands for different domestic user types would be more appropriate, before settling on a single charge for simplicity. A system of tiered bands was agreed for non-domestic sites, with larger sites getting larger daily fixed charges. Bands were used to ensure there was a fair reflection of different sizes of user, but also allow non-distortive fixed charges to be used.

How are standing charges determined for default and fixed tariffs in the domestic retail market?

- 3.16 There are broadly two types of tariffs in the domestic retail market. Default tariffs are those that customers will default onto after a fixed rate contract comes to an end and where the customer does not make an active choice to move to a different tariff. These tariffs are protected by the default tariff cap (The 'price cap').⁶ Tariffs which are actively chosen by customers (including fixed rate tariffs) are not protected by the price cap. Prior to the energy crisis, many more

⁵ "Targeted charging review: decision and impact assessment" at [TCR Final Decision \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/tcr-final-decision)

⁶ Provision for the creation of a Default Tariff Cap was created under the Domestic Gas and Electricity Act 2018. Rules under which the cap operates are set out in Standard Licence Condition (SLC) 28AD of the Gas and Electricity Supply Licences.

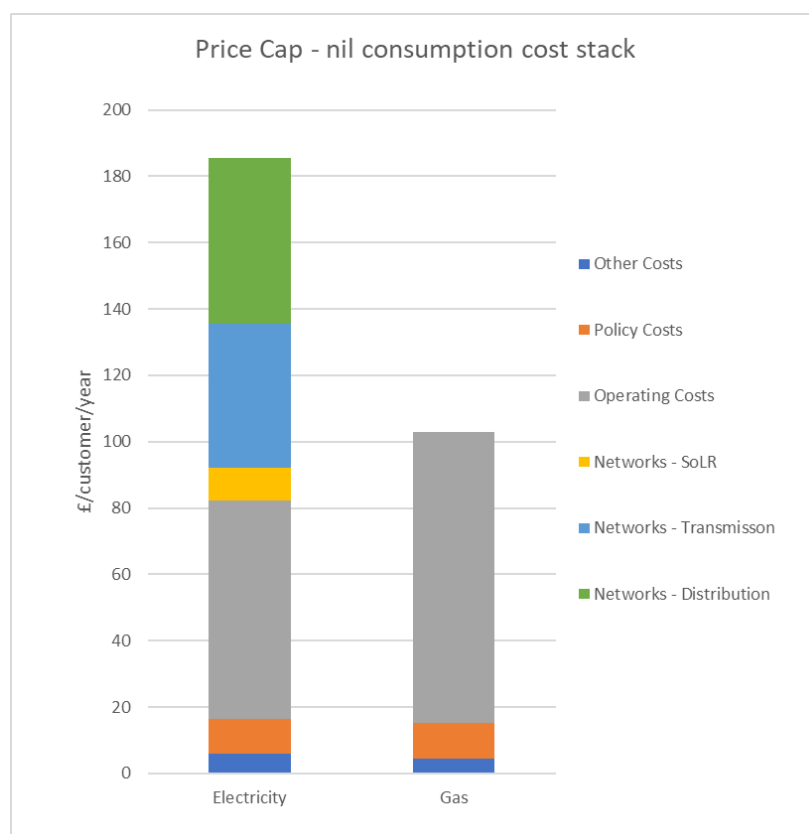
customers made active choices of tariffs. While 44% of all Standard Electricity customers and 46% of all gas customers held fixed rate contracts in June 2022, this had fallen to 10% and 14% respectively in June 2023.⁷

- 3.17 The price cap is not a cap on the level of the standing charge or unit rate, but on the overall cost of supply at a certain volume. As long as the customer is not charged at a level above the relevant price cap for the volume of energy that the customer uses, how a supplier chooses to set the standing charge and unit rate is a commercial decision for them.
- 3.18 In our 2018 price cap decision we considered the risk of setting a cap on standing charges and unit rates which might impact the number of tariff offerings with low or no standing charges.⁸ To mitigate this risk, we included specific provisions in the licence to give suppliers flexibility to offer low or no standing charge tariffs, with higher unit rates, which may benefit customers with lower than typical consumption. Although this derogation still exists in the licence, at the time of writing, no active suppliers have sought to use this flexibility to offer low or no standing charge tariffs.
- 3.19 Under the terms of Standard Licence Condition (SLC) 28AD of the Gas and Electricity Supply Licences, suppliers are permitted to charge a default customer with zero consumption a maximum amount (the 'nil-consumption cap level'). The nil consumption cap level broadly reflects the costs incurred by the supplier which do not vary with a customer's consumption. Generally, this is equivalent to the standing charge (but as set out above, the supplier has commercial freedom to use its own charging structure if this does not breach the cap level). Figure 5 below shows the makeup of the nil cost consumption cap level.

⁷ Department of Energy and Net Zero, 'Quarterly Energy Prices', [Quarterly Energy Prices September 2023 \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/118111/Quarterly_Energy_Prices_September_2023.pdf), p8 (Recovered 5 November 2023)

⁸ See 'Decision – Default tariff cap – Overview document', at [Default Tariff Cap - Overview Document \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/consult/condocs/defaulttariffcap/defaulttariffcap_ovr.pdf), p36

Figure 5: Composition of the nil consumption cap level, October 2023



3.20 The nil consumption cost is made up of a variety of factors, including:

- Network costs (including distribution, transmission and SoLR costs);
- Operating costs (such as billing, metering etc);
- Policy costs (the cost of government schemes such as the Warm Home Discount); and;
- Other costs (such as administrative expenses).

3.21 All these costs, including network costs, are fundamental to the supply of energy to consumers in some way. They must be paid for in some way from customers' bills. If these costs were not met through standing charges, they would be added to unit rates or some other charging methodology.

3.22 Tariffs actively chosen by customers, such as fixed rate tariffs, are not subject to the price cap. Suppliers are free to set their standing charges and could choose to set a standing charge and unit rate, or to set standing charges at zero and recover all fixed costs through (higher) unit rates if they so desired. In both cases, it is a commercial decision made by suppliers.

QUESTIONS FOR STAKEHOLDERS

Q1: What are the barriers to suppliers using the existing flexibility under the price cap?

Q2: Why are suppliers not innovating on standing charges for tariffs not covered by the price cap?

Q3: What changes could Ofgem make to improve provision for lower standing charges under the cap.?

The impact of the TCR on domestic customers

3.23 The effect of the TCR has been to move costs from unit rates into network costs, meaning that suppliers are able to charge these costs to customers who consume zero or very low rates of energy but remain connected to the grid.

3.24 Following implementation of the TCR, charges per domestic site (typically around 12p a day for transmission and 6p a day for distribution charges at current rates)⁹ are added together with other fixed elements.¹⁰ The impact of this can be seen in figure 1 in the previous section, as noticeable jumps in the standing charges in 2022 and 2023 as the distribution and transmission elements were implemented as fixed charges recovered on standing charges.

3.25 It should be noted that these network charges would previously have been incorporated into unit rates, so at typical consumption a reduction in unit rates would have compensated for an increase in standing charges, had wholesale process otherwise been static. However, the implementation of the TCR coincided with the impact of the wholesale gas crisis in 2021 and 2022, and persistently higher energy prices. One of the effects of the increase in wholesale energy prices has been to make a reduction in unit rates due to the TCR less noticeable to users.

The impacts of the TCR on standing charges

3.26 Roughly half of total electricity network costs are now recovered by electricity standing charges, with network costs increasing from 20% of the standing charge to what is expected to be over 60% in 2024, though a small part of that is down to the need to recover costs associated with supplier failure (through the SoLR process, described below).

⁹ At the time of publication in November 2023.

¹⁰ It should be noted that energy suppliers are not bound to pass on this charge to customers through a daily standing charge, but network costs per customer are calculated on a per day basis. We will explore this more in the next section.

- 3.27 We consider that the TCR has brought considerable benefits to the GB electricity market. It has removed costly distortions to the electricity market that were creating additional cost for consumers. In 2019, our analysis suggested that reform of residual charging alone will provide savings to all electricity consumers on their electricity bills of £500m to £1.6bn and system benefit of £1bn to £3.2bn, through increased efficiency.¹¹ In addition to cost savings, the TCR will help to ready the GB electricity network for net zero, by making sure that the costs of investing in the network are borne by those that use it. The fixed charges brought in by the TCR allow us to recover significant amounts of revenue without driving inefficient behaviour. For that reason, we expect them to remain a key part of the charges in the long term, particularly in the context of increases in the allowed revenues due to the system investment.
- 3.28 However, whilst the TCR has undoubtedly benefited the market as a whole, it has also resulted in an increase in standing charges paid by domestic customers. The overall impact of the TCR should not be to increase domestic bills on aggregate, as the network costs which were previously charged as unit costs have been charged as fixed standing charges. However, domestic customers do not pay standing charges and unit rates in the same amount, and the impact of this change will depend on customer usage. Some domestic customers, especially those who typically use lower than average amounts of energy, may be paying more than before.

Will Ofgem revisit the impacts of the TCR?

- 3.29 We need to continue to ensure that all users of the network make a fair, proportionate contribution to those costs as the system changes. The aim of the TCR has been to remove distortions across the whole of the electricity sector, and we continue to believe that it will be successful in doing so. However, we recognise the impact that shifting some network costs to fixed charges has had on some customers. The time is right to look at what we can do to minimise the impact of this change, particularly on lower-income and vulnerable customers.
- 3.30 We propose to carry out some post-implementation analysis looking not only at how the residual recovery reforms have gone, but how they may need to change in the light of larger allowed revenues and new technology. We are particularly mindful of the potential for new distortions to emerge, but also for the need for

¹¹ "Targeted charging review: decision and impact assessment" at [TCR Final Decision \(ofgem.gov.uk\)](https://www.ofgem.gov.uk), p142

charges to be stable, predictable and fair for all users. As part of this post-implementation analysis, we will consider the impact on lower-consuming customers, and whether and how we can minimise the negative impacts of moving network charges to fixed charges through the TCR process. Alongside this work, we will look at alternative policy measures that may mitigate these impacts.

- 3.31 Ultimately, however, whilst Ofgem can (and does) work with industry to make networks work as efficiently as possible, we cannot make network costs go away. They must be recovered from users somehow, using some allocation mechanism, and that will include recovery from domestic and non-domestic customers.
- 3.32 We have already signalled to industry that we would like feedback from users on how they think residual recovery will need to adapt in the future, and how it interacts with key areas such as planned network investment, complex sites and consumer vulnerability.

QUESTION FOR STAKEHOLDERS

Q4: As a result of TCR and changes to the recovery of residual costs, domestic consumers with very low consumption now bear a share of fixed network costs which is more in line with the cost of maintaining access to gas and electricity networks. Is this fair? Should more be done to shield these customers from these costs?

Impact of Supplier of Last Resort (SoLR) costs

- 3.33 As can be seen from figures 1 and 5 above, the costs arising from the appointment of Suppliers of Last Resort (SoLR) during the retail energy crisis of winter 2021 and 2022 had a significant impact on standing charges. These are the costs of absorbing customers of failed suppliers borne by the appointed SoLR, usually for a six-month period following appointment. The costs typically include administrative costs and costs of procuring fuel which are not recovered from customers, and which the SoLR does not volunteer to cover themselves, which the SoLR is able to recover from the networks through a "Last Resort Supply Payment" often referred to as a "SoLR levy".
- 3.34 The costs associated with the SoLR process are split across both fixed (standing charge) and volumetric (unit rate) charges. 45% of the SOLR levy costs are recovered from gas domestic consumers via a volume charge, whilst the remaining 55% of costs are recovered from electricity domestic consumers via a standing charge.

- 3.35 Stakeholders have raised concerns about the impact of these costs on consumers in the past, and we considered whether to shift recovery of SoLR levy costs in electricity to a usage-based (volumetric) basis in August 2022.¹² Our analysis at the time found that whilst some customers would see a relatively small benefit, this would be offset by a number of high-consuming customers, including numbers of vulnerable customers, who would pay more.
- 3.36 Whilst it is possible that we may see more supplier failures in future, the majority of the impact of the 2021/22 energy crisis is now in the past. Having considered our approach to recovery of SoLR levy costs as recently as summer 2022, we do not propose to reconsider this approach at the present time.

Why have standing charges not risen in the gas sector?

- 3.37 Figures 1 and 2 above demonstrate a separation in approach between gas and electricity markets regarding charging of standing charges, and this becomes especially apparent in the years following Autumn 2021, when gas standing charges are broadly static when measured in 2023 prices.
- 3.38 The primary reason for the lack of change in gas standing charges is that we have not seen the same underlying issues in the gas sector driving the need for the kind of policy intervention along the lines of the TCR. Gas networks and transmission systems are fundamentally different from those in electricity, and some systems which operate in electricity (for instance balancing charges) do not have equivalents in gas. This means that the opportunities for moving consumption to avoid network costs are less apparent in gas. In addition, market participants in the gas market are different from those in electricity (for instance gas nil-consumption levels are not influenced by network cost fluctuations to the same extent as in electricity).

Why do standing charges vary from region to region?

- 3.39 As with any other commodity, the cost of transporting and distributing energy varies between regions.
- 3.40 Suppliers generally set their prices based on differences in network charges, creating regional differences in standing charges for electricity. For customers on default tariffs, the level of the price cap varies by region reflecting regional cost

¹² See "Follow up on our review into the arrangements for recovering the costs of supplier failure", at [Follow up on our review into the arrangements for recovering the costs of supplier failure \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/consult/condocs/supplierfailure/supplierfailure_220818.pdf), 18 August 2022 (recovered 31 October 2023).

differences (so suppliers are able to set their prices differentially by region under the cap, on a cost reflective basis). This means that the price paid by customers reflects how much it costs to transport energy to those customers and varies due to the complexity of the infrastructure such as demand and population density of different distribution network regions.

- 3.41 From April 2022, network charges are recovered on a fixed rather than variable basis. As we explained in the section above, this means that suppliers generally choose to recover the cost of these charges from their customers through standing charges rather than unit rates. For the reasons given above, network charges will vary between regions, which means that some regions will see a higher increase in standing charges than others. However, at median consumption (a typical customer), this increase in standing charges will be offset by an equivalent reduction in unit rates and the impact on a customer within regions will be broadly neutral.
- 3.42 As we have explained above, by far the largest contributory factor to unit rates is the wholesale cost of electricity or gas, which has risen sharply since the energy crisis. For this reason, the impact of reduction in unit rates from the removal of network charges may be less obvious to customers.

Differences in standing charges across regions

- 3.43 Tables 1 and 2 below show the change in regional variations in standing charge rates across regions for electricity and gas respectively. The tables show the average standing charges for tariffs launched between April and October 2021 and in October 2023 in Distribution Network regions, based on the data that Ofgem holds.
- 3.44 Table 1 shows the average percentage difference by region in electricity standing charges, relative to the average annual cost across all regions. The percentage regional differences relative to the national average as derived from the price cap standing charges are also shown for comparison. Also shown is the percentage increase in the average standing charge for those regions between April - September 2021 and October 2023.
- 3.45 The results show that the regional variations in standing charges was generally closely aligned with the regional variation in overall cost of energy, as measured by the price caps during both time periods. There was less regional variation in electricity standing charges for new tariffs in the period April to September 2021 (between -8% and +8%) relative to Oct 2023 (between -29% and +17%). Whilst there was less regional variation in the price cap standing charge rates at the

time, we also observed a greater number of smaller suppliers in the market at the time who did not vary standing charges regionally, but only reflected regional price variations in their unit rates. The percentage regional differences shown in Oct 2023 are very close to those seen in the overall cost of energy under the price cap, a reflection on that fact that most suppliers charged close to the price cap at this time. Most regions which priced under the national average in April to September 2021 were still priced under the national average in October 23 and likewise for those priced over the national average, with the exception of the MANWEB region, which is now higher than the national average, having seen the largest percentage increase of 150%. The London region saw the smallest increase in standing charges between Apr - Sep 2021 and October 2023 at only 63%.

Table 1: Regional differences in electricity standing charges for new tariffs in April to September 2021 and October 2023. (Source: Ofgem data)

	Average annual standing charge Apr - Sep 2021 (£/year)	Average % regional difference in standing charge from national average across all tariffs, Apr - Sep 2021	% regional difference in overall tariff cost, Apr - Sep 2021	Average standing charge Oct 2023 (£/year)	Average % regional difference in standing charge from national average across all tariffs, Oct 2023	% regional difference in overall tariff cost, October 2023	% increase in average standing charge 2021-2023
East Midlands	89.44	-3.0%	-4.5%	182.71	-5.2%	-5.0%	104.3%
Eastern	87.98	-4.3%	-3.5%	158.37	-18.0%	-17.5%	80.0%
London	84.42	-7.9%	-6.3%	137.71	-28.8%	-27.8%	63.1%
MANWEB	89.78	-2.7%	-5.5%	224.83	16.9%	16.6%	150.4%
Midlands	93.53	1.4%	0.9%	196.48	2.0%	1.9%	110.1%
Northern	96.77	4.9%	6.3%	208.40	8.3%	7.7%	115.4%
NORWEB	90.04	-2.2%	-2.0%	186.04	-3.5%	-2.9%	106.6%
Scottish Hydro	99.58	8.0%	10.1%	212.83	10.6%	11.3%	113.7%
Scottish Power	93.53	1.3%	0.0%	221.63	15.2%	16.4%	137.0%
Seeboard	89.14	-3.1%	-3.4%	172.85	-10.4%	-10.8%	93.9%
Southern	89.85	-2.5%	-3.1%	182.44	-5.4%	-6.3%	103.1%
SWALEC	92.85	0.6%	0.0%	196.30	1.9%	1.6%	111.4%
SWEB	95.85	3.8%	3.2%	212.91	10.6%	10.0%	122.1%
Yorkshire	97.45	5.6%	7.8%	203.39	5.6%	5.0%	108.7%
National Average	92.16			192.64			109.0%

3.46 Table 2 shows the show the average percentage difference in standing charge by region in gas, relative to the average across all regions, for tariffs launched in the period April - September 2021 and in October 2021. Also shown is the percentage increase in the average standing charge for those regions between April - Sep 2021 and Oct 2023.

3.47 The results show that there was little regional variation in standing charges in the period April - Sep 2021, which corresponds to the lack of regional variation in the overall cost of energy under the price cap at the time. There was very little

regional variation in standing charges in Oct 2023, also reflecting the consistency of the overall cost of energy across all regions for gas.

Table 2: Regional differences in gas standing charges for new tariffs in April to September 2021 and October 2023. (Source: Ofgem data)

	Average standing charge Apr - Sep 2021 (£/year)	Average % regional difference across all tariffs April - Sep 2021	% regional difference in price cap rates	Average standing charge Oct 2023 (£/year)	Average % regional difference across all tariffs Oct 2023	% regional difference in price cap rates	% increase in standing average standing charge 2021-2023
East Midlands	87.02	0%	0%	101.38	0.01%	0.00%	16.5%
Eastern	87.06	0%	0%	101.38	0.01%	0.00%	16.4%
London	87.29	0%	0%	101.37	0.00%	0.00%	16.1%
MANWEB	87.06	0%	0%	101.37	0.00%	0.00%	16.4%
Midlands	87.06	0%	0%	101.38	0.01%	0.00%	16.4%
Northern	87.03	0%	0%	101.38	0.01%	0.00%	16.5%
NORWEB	87.09	0%	0%	101.37	0.00%	0.00%	16.4%
Scottish Hydro	87.32	0%	0%	101.38	0.01%	0.00%	16.1%
Scottish Power	87.16	0%	0%	101.38	0.01%	0.00%	16.3%
Seeboard	87.09	0%	0%	101.37	0.00%	0.00%	16.4%
Southern	87.11	0%	0%	101.37	-0.01%	0.00%	16.4%
SWALEC	87.05	0%	0%	101.37	-0.01%	-0.03%	16.5%
SWEB	87.09	0%	0%	101.36	-0.01%	-0.03%	16.4%
Yorkshire	87.09	0%	0%	101.38	0.01%	0.00%	16.4%
National Average	87.11			101.37			16.4%

QUESTION FOR STAKEHOLDERS

Q5: What are the reasons for regional variations in electricity standing charges?

Do other regulated sectors have standing charges?

3.48 Retail energy markets are not the only sector which uses standing charges in bills. We have analysed some other regulated sectors to look at how charging structures operate and outline our findings below.

Standing charges in the retail water market

3.49 Metered charges are growing in the water sector but are still less universal than in the energy sector. Metered domestic properties are usually billed for a standing charge (a fixed annual fee) and a volumetric charge for water and wastewater services (based on water usage). Unmetered domestic properties are billed based on a standing charge and a variable charge based on the rateable value of the property. Ofwat indicates that standing charges constitute about 10% or less of the average water bill in Great Britain.

Telecommunications (broadband and mobile phones)

3.50 In the past, the telecommunications industry's pricing structure for fixed line telephone calls bore some similarities with that of the retail energy market; a fixed line rental cost (although this was subsidised in order to expand access and secure network benefits) and variable unit costs (expressed as per-minute call costs, with variable rates for local, national and international calls).

3.51 The introduction of competition and technological advancement in the sector has led to a change in the nature of the product offer to customers. Modern broadband products are differentiated by speed of broadband access rather than capacity, with customers paying a single rate for different speeds of product rather than any unit rate.¹³ In the mobile market, there is high competition for bundled products of handsets, data plans, call minutes and SMS messages. The mobile sector has never had standing charges.

3.52 There are no regulations underpinning the composition of customer bills in the telecommunications industry. However, there are regulated wholesale prices for some input products, which may affect the prices passed on to consumers. For example, the price of 'access' is regulated, with a price set for renting a copper line from Openreach (BT) between the local exchange and the end-customer.

3.53 There is also no regulation of retail or wholesale mobile data prices. Most retail packages are based on a fixed monthly charge and data usage allowance, with a small proportion of retail revenue generated from data usage overage.

¹³ Fixed-line telephone calls may still be charged on a 'pay-as-you-go' basis, with a line rental and unit rate, but their use is increasingly rare amongst consumers and is intended to be phased out in future with the retirement of copper wire phone lines. Most providers also offer bundled telephone call products.

- 3.54 Competitive dynamics in the communications industry have resulted in increased efforts for customer certainty, with a greater proportion of customer bills coming from a fixed monthly fee and a smaller proportion from usage driven charges for voice or data coverage.
- 3.55 Ofcom does not intervene in setting retail price levels.¹⁴ Instead, it protects consumers by ensuring price transparency, an example of which being a recent enforcement programme relating to disclosure of in-contract price rises to customers at sign-up.¹⁵

QUESTION FOR STAKEHOLDERS

Q6: Can we learn from other sectors about how to improve suppliers' tariff offering in the UK energy market?

¹⁴ Ofcom. [Telecoms price rises – what are your rights?](#) (viewed recovered on 2 November 2023)

¹⁵ Ofcom. [Ofcom probes transparency of telecoms price rises](#) (viewed on 2 November 2023)

4. How does Ofgem expect standing charges to develop in future?

Section summary

In this section we look at some of the factors that will influence rates of standing charges in future.

4.1 In the previous section we examined the costs that contribute to standing charges and how these have changed in recent years. As we have seen, levels of standing charges in both domestic and non-domestic markets are ultimately a commercial decision taken by suppliers; therefore, we cannot predict with absolute certainty what they will be in future. However, as we explore in the next section, in practical terms suppliers' standing charges for standard variable tariffs are influenced by the nil consumption level of the price cap. In this section we explore some of the factors that may contribute to the direction of standing charges in the near future.

How do we expect standing charges for domestic customers to develop in future?

Network costs

- 4.2 Electricity network charges could drive higher charges under the electricity nil consumption cap level in 2024/25. Increases in Distribution Use of System (DUoS) charges have resulted in a lag in 'true ups', which is a reconciliation process used to ensure the initial estimate of residual charges accurately reflects the final cost to distributors. Additionally, these DUoS increases required adjustments to be made for inflation between Ofgem's network price controls (known as RIIO-1 and RIIO-2). This will mean that an additional one-off adjustment will be made to network costs in 2024/25, which will increase these costs. We expect that this will be a one-off adjustment and these costs may therefore fall in 2025/26, although we cannot predict this with certainty.
- 4.3 Additionally, changes to Transmissions Network Use of System (TNUoS) charges and the forecasted introduction of the Energy Intensive Industries (EII) levy may impact future standing charges. The EII Levy seeks to fund compensation for EIIs on the costs of using the electricity grid. This is part of the overarching Government aim to reduce electricity costs for EIIs in order to make Britain's strategic EIIs more competitive and tackle the challenge of indirect carbon leakage. The government intends to legislate with a Statutory Instrument in

Spring 2024 to enable changes to be made to calculations and for savings to start to materialise from April 2024. However, this remains with government and a decision has not yet been made. As such, the impact this could have on standing charges is unclear.

- 4.4 As a result of DUoS increases, and to a lesser extent TNUoS charges and the potential introduction of the EII levy, we expect continued upward pressure on the electricity standing charge in 2024/25.

Supplier of Last Resort costs

- 4.5 Figures 1 and 5 in the previous section shows that costs associated with the SoLR process were a significant contributor to the increase in standing charges in electricity in 2021 to 2023. These costs were approximately £34 per customer per year in 2022/23 and had fallen to £10 per customer per year in 2022/23. At the time of publication, the most recent appointment of a SoLR was in Summer 2022, and the majority of historic SoLR levy costs will have passed through the system by 2024/2025. We expect the impact of SoLR levy costs on Standing Charges to be negligible after this point, unless we observe more supplier failures. This will provide some relief for standing charges, although future supplier failures can never be ruled out.
- 4.6 In addition to those suppliers whose failures were managed through the SoLR process, the failure of Bulb Energy in 2021 was managed through a Special Administration Regime (SAR). A SAR is administered in a different manner to a SoLR and the costs are also recovered differently. The National Audit Office's recent report into Bulb Energy notes that it is possible that some costs of the SAR will be claimed back "from the wider energy sector through consumers' energy bills."¹⁶ Depending on the decision made by government it is possible that these costs may be recovered through standing charges.

Other electricity costs, and gas nil consumption costs

- 4.7 The other costs that make up the nil consumption level within the price cap (policy costs, operating costs such as billing and metering, and other costs for suppliers' headroom allowance) are expected to remain stable.
- 4.8 Similarly, since gas standing charges are not influenced by network costs, we expect these to remain relatively stable.

¹⁶ National Audit Office, 'Investigation into Bulb Energy' at [Investigation into Bulb Energy \(nao.org.uk\)](https://www.nao.org.uk), p30

Standing charges and levelisation

- 4.9 Levelisation is the process of redistributing or adjusting costs between payment methods to make charges more equitable.
- 4.10 There have been concerns over Prepayment Meters (PPM) and the premiums that consumers pay for using a specific payment method. The Chancellor announced in the Spring Budget (2023) that the Energy Price Guarantee (EPG) would align costs for prepayment meter and direct debit customers through a standing charge discount for PPM customers. The EPG is due to end in March 2024 and the Chancellor has asked Ofgem to consider an enduring bill payer funded scheme to ensure that those on PPMs no longer pay a premium for their energy.
- 4.11 In April 2023, we published a Call for Evidence (CfE) on the levelisation of payment method cost differentials¹⁷ and following this, a policy consultation in August 2023.¹⁸ It included an initial preference for levelising prepayment meter and direct debit standing charges, and also consulted on levelising debt related costs between customers.
- 4.12 Following feedback, our current position is that there may be a case for levelisation to address specific issues with the current cost allocations in the price cap. Our levelisation proposal, which is subject to change following statutory consultation, is to levelise the PPM and DD standing charges and debt related costs between standard credit and direct debit. We also propose to introduce a reconciliation mechanism.
- 4.13 Our proposal ultimately decreases the magnitude of the PPM standing charge and increases the magnitude of the DD standing charge but does not impact the total cost or what costs are recovered through the standing charge.
- 4.14 We expect to make our final decision early next year following consideration of stakeholder feedback to the statutory consultation.

¹⁷ [Levelisation of payment method cost differentials: a call for evidence | Ofgem](#)

¹⁸ [Levelling the cost of standing charges on prepayment meters | Ofgem](#)

5. Standing charges and the domestic retail market

Section summary

In this section, we examine the products offered by suppliers in the domestic retail market, and attempt to understand reasons for the apparent lack of variety in products offered by suppliers.

We look at rising block tariffs, which have been suggested by some stakeholders as an alternative to tariffs with standing charges.

Finally, we analyse the impact on customers of moving costs from standing to volumetric charges, based on the existing status quo.

Questions

Q7: Why do so few suppliers offer multi-tier or zero standing charge tariffs to their customers?

Q8: Why are zero standing charge tariffs no longer offered in the market, with the exceptions cited in this paper?

Q9: What measures could Ofgem take to improve the range of tariffs available to domestic retail customers?

Q10: Why do no suppliers offer rising block tariff products at present? Would these products offer benefits to consumers?

Q11: How significant an impact do standing charges have on customers' incentives to use energy efficiently? What evidence can you provide that this is the case?

Q12: Are there any forms of intervention in standing charges that Ofgem might consider that would minimise the risk of producing negative outcomes for some customers?

Q13: How can we identify the complex needs of vulnerable customers and ensure that they are able to receive tariffs that benefit them the most?

What is the current product offer in the domestic retail market?

5.1 Many stakeholders, including consumers and their representatives, the media, and Members of Parliament, have called for Ofgem to take action to limit standing charges, including abolishing them entirely. In this section, we look at whether existing alternatives to tariffs with a Standing Charge exist in the retail market, and what the impact of shifting charges away from standing charges to volumetric charges might be.

Tariff availability in the domestic retail market

5.2 In June 2016, the Competition and Markets Authority directed Ofgem to change the standard conditions of the electricity and gas supply licences to remove a requirement that all tariffs must have a standing charge (even if this was set at zero).¹⁹ This requirement had previously been introduced by Ofgem's Retail Market Review (RMR) in 2010 and was intended to promote transparency for consumers. The CMA expected that their remedy would promote innovation amongst suppliers and result in new products and tariffs.

Standard Variable Tariffs (SVT)

5.3 Our analysis indicates that there is very little variety in suppliers' offering of standard variable tariffs (SVTs) in terms of tariff composition. 78% of customers in both the gas and electricity sectors are on tariffs with standing charges within 1p of the price cap nil consumption level.

Multi-tier tariffs

5.4 A 'Multi-tier tariff' refers to a pricing structure for electricity consumption that involves different rates or tiers based on the amount of energy used. Multi-tier tariffs do not have standing charges. At present, out of 37 active energy suppliers for whom we have data, only three suppliers with a multi-tier tariff in the market. Two of these suppliers are specialist prepayment-only suppliers. Where suppliers offer multi-tier tariffs, in effect these offer little variation from the nil consumption level. These tariffs also offer a multi-tier break volume with a break point (the level at which the unit rate of a given tariff changes from one price to another) of 2kWh, meaning that the first up to 2kWh of consumption each day incurs a significantly higher unit rate. A break point this low means the payment of a high initial unit rate is essentially unavoidable and effectively acts as a standing charge, unless the customer uses no energy at all that day. By multiplying the multi-tier break volume by the difference between the first and second-unit rates, we can calculate an implied standing charge. Our analysis shows that over 80% of consumers on multi-tier tariffs also have implied standing charges within 1p of the cap nil consumption level.

5.5 This has not always been the case. The CMA's 2016 investigation into the retail energy market noted that "Some suppliers offer zero standing charge tariffs

¹⁹ Competition and Markets Authority. '[Energy market investigation: Final report](https://publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/111111/energy-market-investigation-final-report.pdf)' at [Energy market investigation: Final report \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/111111/energy-market-investigation-final-report.pdf), p.773 (recovered on 6 November 2023)

which are cheaper than the price cap at very low consumption but may become more expensive at higher consumption.”²⁰

5.6 It is clear that in the intervening seven years between the CMA’s remedy and the publication of this paper, we have not seen the diversity of tariffs introduced to the domestic retail market that the remedy was intended to promote. Whilst we recognise the difficulties that the retail market has faced in the intervening period, it seems timely to investigate this matter once again. If the domestic market produced a variety of tariffs and marketed them to customers in a manner that was transparent, it is unlikely that we would have seen the same level of public concern around standing charges. We intend to explore the reasons behind this lack of variety in suppliers’ offer to customers as part of an engagement arising from this work.

QUESTIONS FOR STAKEHOLDERS

Q7: Why do so few suppliers offer multi-tier or zero standing charge tariffs to their customers?

Q8: Why are zero standing charge tariffs no longer offered in the market, with the exceptions cited in this paper?

Q9: What measures could Ofgem take to improve the range of tariffs available to domestic retail customers?

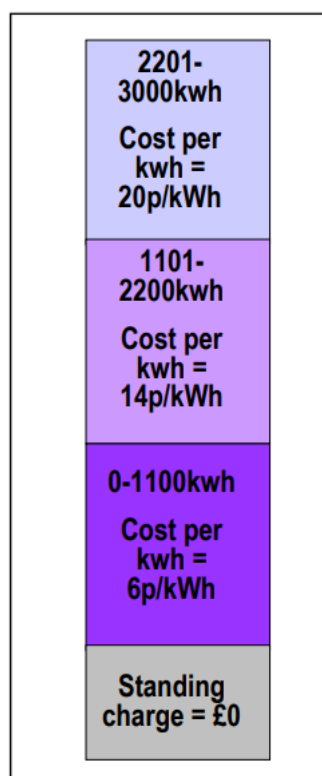
How would a typical rising block tariff affect a customer’s usage in practice?

5.7 A ‘rising block tariff’ is a type of multi-tier tariff where customer’s consumption is charged at progressively higher unit rates for consumption in different tiers or blocks. This would mean the rate per unit of electricity increases as the volume of consumption increases. Users who use no energy would not make a payment that day. Rising block tariffs have been advocated as an alternative to tariffs with standing charges by, amongst others, the Energy and Net Zero Select Committee.²¹ At present, we are not aware of any supplier that offers a rising block tariff to domestic retail customers.

²⁰ Competition and Markets Authority, “Energy market investigation: Final report” at [Energy market investigation: Final report \(publishing.service.gov.uk\)](https://publishing.service.gov.uk), p1010

²¹ See Energy Security and Net Zero Committee Oral evidence: Preparing for the winter, HC 1720 , at <https://committees.parliament.uk/oralevidence/13613/pdf/>

Figure 6: An example of a rising block tariff



- 5.8 Rising block tariffs would offer significant benefit to those consumers who use lower amounts of energy. They would also incentivise consumers to reduce their overall energy consumption. Higher energy users would be compensated in part by the lack of a standing charge, but could end up paying more for their energy, especially as their marginal cost at higher levels of consumption could be materially higher. This could mean that simple rising block tariffs would not be suitable for some vulnerable customers with high energy consumption needs, or for customers with electric heating.

QUESTION FOR STAKEHOLDERS

Q10: Why do no suppliers offer rising block tariff products at present? Would these products offer benefits to consumers?

Suppliers should consider offering zero standing charge tariffs to customers

- 5.9 As we have outlined in previous sections, there is no obligation upon suppliers to offer a standing charge to their customers, and in the prepayment sector some suppliers do offer a multi-rate tariff with zero standing charge. The nil consumption cap level under the price cap represents the maximum annual cap level a supplier can charge a household with zero consumption. From this a

supplier can work out the implied daily standing charge. However, this does not obligate a supplier to charge this amount.

- 5.10 We note that since standing charges have risen, some suppliers have made public calls to abolish or reduce standing charges,²² with some offering 'standing charge holidays' or reductions in comparison to the current Price Cap.
- 5.11 There is no obstacle in our current regulations to suppliers offering products without a standing charge to their customers, should they choose to do so. We encourage suppliers to consider how they could produce products that offer genuine choice to customers, especially those that may benefit from lower standing charges.

Can standing charges impact net zero transition?

- 5.12 Shifting charging from unit-based to fixed charges may impact the incentives that customers have to use energy. Generally speaking, increasing the unit rate provides a stronger incentive to use less energy. Moving charges to standing charges rather than unit rates arguably weakens incentives for customers to reduce consumption.
- 5.13 A second order impact of moving charges from unit costs to standing charges could be to lengthen the period it takes for a customer to recover the upfront outlay on energy efficiency measures such as home insulation through cost savings. This could make such measures less appealing to consumers.
- 5.14 However, moving electricity (as opposed to gas) charges to standing rather than unit rates may have the effect of making some low-carbon technologies more affordable for domestic customers, such as electric vehicles and heat pumps. These technologies use electricity rather than fossil fuels and may therefore reduce carbon emissions.

QUESTION FOR STAKEHOLDERS

Q11: How significant an impact do standing charges have on customers' incentives to use energy efficiently? What evidence can you provide that this is the case?

²² [Chris O'Shea - Changes are needed to make the energy sector simpler and more transparent | Centrica plc](#), recovered 7 November 2023; and [7/10 of public say ditch unfair standing charges, as OVO protects its customers from October rise and renews call for a social tariff - OVO Group](#), recovered 10 November 2023

Distributional impacts of shifting some or all standing charges to volumetric costs.

- 5.15 In previous sections of this paper, we have explored why standing charges have grown as a proportion of customer bills in recent years, particularly in the electricity sector. As we have seen, this growth in standing charges has seen some calls from stakeholders for Ofgem to take action to reduce their impact on consumers, including by abolishing them.
- 5.16 Ofgem’s principal objective, set out in legislation²³, is to protect the interests of existing and future consumers and, in performing our functions, have regard to the interests of certain groups of vulnerable consumers, amongst other things. With this in mind, in this section we examine what impact such an action would have on different types of customer.
- 5.17 We have undertaken analysis based on consumer archetypes developed for us by the Centre for Sustainable Energy (CSE). These archetypes allow us to segment consumers by income, energy usage, age, residential position, life-stage and eligibility for government schemes, amongst other things.²⁴ There are 24 archetypes in total; they cover all households in Great Britain and are mutually exclusive and exhaustive. These archetypes allow us to identify factors which affect how much different domestic retail customers pay for their energy and model the impacts of changes on these broad categories.
- 5.18 Using these archetypes, we conducted analysis to look at the impact on customers’ annual bills of charging customers on a volumetric basis rather than through standing charges. We have used the existing status quo as a starting point and modelled the impact of a reduction in standing charges on certain groups of customers. To calculate customer ‘gains’ and ‘losses’ (representing a reduction or increase in annual bills, respectively) we have modelled an indicative transfer of 50% of standing charges to unit rates, at October 2023 prices; abolition of standing charges in their entirety would mean that customer gains or losses would be double the amount shown.

²³ Section 3A Electricity Act 1989 and Section 4AA Gas Act 1986

²⁴ The archetypes segment customers by heating fuel type, dwelling type, tenure, HRP economic status and age, number of children in the household, rurality, whether the household contains customers on disability benefits, property EPC rating, and an assessment of whether the households making up the archetype are early adopters of technology, amongst other things. There are fewer archetypes for gas customers as not all households have mains gas.

- 5.19 Our base case was the impact of halving the standing charge from the levels of 53p/day and 29p/day for electricity and gas, respectively, as at October 2023, and charging this to customers via a volumetric (unit) rate instead. As a result, under this model households who use less gas and electricity than average will see their bill fall, whereas those who use more than average will pay more.
- 5.20 The starting point for this analysis is the status quo; we are looking at the impact of moving charges away from standing to volumetric charges for domestic customers based on the distribution as at October 2023. The purpose of this exercise is to examine the distributional impacts of such a move, rather than any policy mechanism which would have this effect.
- 5.21 It should be noted that this is a static analysis and we do not attempt to model dynamic effects. If this measure were to be implemented in practice, dynamic effects would undoubtedly occur. Increasing the unit cost of energy could have the effect of disincentivising and therefore reducing consumption.
- 5.22 Furthermore, moving cost allowances between fixed and volumetric charges under the existing price cap mechanism could result in windfall gains for suppliers and ultimately make consumers worse off, if not carefully managed. This is because moving fixed costs to volumetric at the benchmark consumption levels used to calculate the price cap is not a symmetrical adjustment. Setting a benchmark consumption in line with the prevailing median consumption at the time (2017) rather than mean consumption was one of the ways the price cap accounts for uncertainty. As current mean consumption remains higher than the benchmark consumption level assumed in the price cap, moving costs from the standing charge to unit rate would, considering the market as a whole, increase the revenues suppliers can make under the price cap. This means that on aggregate, without corrective mitigations customers overall could lose out as a result of a blanket measure to move standing charges to unit rates, with suppliers standing to gain. Should any further consideration be given to the appropriate allocation of costs under the nil consumption cap level versus costs at benchmark consumption to remedy high standing charges – we make clear that we would seek to correct for this mean-median issue to ensure that suppliers do not see a windfall revenue gain.
- 5.23 Our analysis shows that, whilst generally customers in lower-income groups use less energy and therefore would benefit from a shift from fixed standing charges to charging on a volumetric basis, this is not true of all lower-income households. In particular, lower-income households who rely on electricity for heating would find themselves paying more. The analysis identifies groups of consumers who

have amongst the highest rates of electricity consumption of all, despite being of particularly low incomes.

- 5.24 Table 3 shows the impact of moving half of the charging currently accrued from standing charges for electricity to volumetric charging for domestic retail customers. This is based on the classification of income groups in the CSE archetypes.
- 5.25 It should be noted that in this analysis, a 'gain' is represented by a reduction in the household's annual bill and is therefore represented by a negative number. Conversely, a 'loss' is an increase in the annual household bill.
- 5.26 Our analysis shows that whilst 5.5 million low-income households would benefit from a decision to move standing charges to volumetric charges in electricity, approximately 1.2 million low-income households would lose out as a result. The average loss per annum for this cohort in electricity under our base case would be almost twice the average annual gain for 'winning' customers.
- 5.27 In higher income categories the number of gaining and losing households are more evenly distributed, although broadly there are more 'losers' than 'winners'.

Table 3: numbers of domestic households gaining and losing from a hypothetical transfer of 50% of billing from standing to volumetric charging, electricity.

Income group	No. of losing households	Total bill increase from 50% transfer from SCs to volumetric charging, £ million	Average bill increase per losing household, £/annum	No. of gaining households	Total bill reduction from 50% transfer from SCs to volumetric charging, £ million	Average bill reduction per gaining household, £/annum
Low income	1.2	54.6	44.52	5.5	-119.6	-21.90
Lower middle	1.3	3.9	2.93	4.4	-52.7	-12.04
Middle/ Upper-middle	4.5	94.6	21.11	2.6	-52.7	-20.06
High	4.3	83.6	19.64	3.2	-11.6	-3.60
All households	11.3	236.6	20.96	15.7	-236.6	-15.07

- 5.28 Table 4 below shows a similar analysis for households with gas connections, using the same methodology as for electricity above. This shows fewer households gaining from such a transfer and a lower overall gain for those households; unlike in electricity, there are a greater number of 'losing' than 'gaining' households. In

this analysis, no households in upper income bands gain from a transfer of billing from standing to volumetric charging.

Table 4: numbers of domestic households gaining and losing from a hypothetical transfer of 50% of billing from standing to volumetric charging, gas

Income group	No. of losing households	Total bill increase from 50% transfer from SCs to volumetric charging, £ million	Average bill increase per losing household, £/annum	No. of gaining households	Total bill reduction from 50% transfer from SCs to volumetric charging, £ million	Average bill reduction per gaining household, £/annum
Low income	1.8	1.0	0.58	3.7	-49.3	-13.38
Lower middle	3.8	20.0	5.31	1.9	-27.8	-14.32
Middle/ Upper-middle	1.5	10.0	6.80	2.6	-20.6	-7.84
High	7.2	66.7	9.20	-	-	N/A
All households	14.3	97.7	6.85	8.3	-97.7	-11.84

5.29 These classifications disguise a wide range of outcomes. Amongst customers with the lowest incomes,²⁵ the main driving factor in whether a customer benefits from standing charges in electricity is whether they have mains gas as their primary source of heating. Those that do not have gas heating see a significant negative impact from a move away from standing charges. This includes customers who have communal heating (for example in social housing).

Implications for policy measures

5.30 This analysis highlights the risks of a broad-based policy approach such as the abolition of standing charges. From a starting point as at October 2023, moving costs from standing to volumetric charges would create more 'winners' than losers in electricity, but the opposite in gas. In both sectors, whilst most lower-income households would gain from abolition of the standing charge, significant numbers would also see their bills rise, all other things being equal. The group that is of greatest concern is likely to be low income households with medical needs that force high energy usage, but others such as retired households which are off the gas grid would also be adversely impacted.

²⁵ In this analysis, this is defined as a gross household income below £32,668 per annum.

QUESTION FOR STAKEHOLDERS

Q12: Are there any forms of intervention in standing charges that Ofgem might consider that would minimise the risk of producing negative outcomes for some customers?

Assessment of overall equivalised impact on all consumers

- 5.31 When calculating the impact of an intervention across income groups, it is usual to consider equivalised impacts, that is, considering that lower-income households will have a greater marginal utility of each additional pound saved (or lost) than higher-income households. In effect, this means that households at lower income levels will value a reduction in their bill more than higher income households, and this should be reflected in calculations when deciding policy. To do this, we have 'equivalised' the bill changes across different income levels to account for relative marginal utility of consumption.
- 5.32 This calculation shows that our base-case reduction would lead to a lowering of the average electricity bill by £16.92 per household per annum, and lowering the gas bill by £7.44 per annum, or a combined figure of £21.53 per household per annum, after equivalisation. In effect, this means that despite being revenue-neutral, it would be broadly progressive in impact. This is because more customers at the lower end of the income distribution will be 'winners' as a result of such a transfer of charges from standing to volumetric, and those customers have a greater marginal utility (i.e. they will obtain greater value) from those savings.

Potential geographical impacts of a hypothetical transfer of cost from standing to volumetric charges

- 5.33 We would expect all regions to contain a mix of customers across all archetypes, and therefore the geographical impact of transferring charges from standing to volumetric would be less pronounced than across income groups. However, geographical information contained within the archetypes does allow us to estimate the impact on different regions of such a hypothetical transfer, allowing for the limitations of a static model, which is set out below. Whilst there are some differences between regions, the average impact is small. The analysis shows a range of approximately £12 per annum between regions which would benefit most from a shift to volumetric (the north-east) and that which would lose the most (Wales).

Table 5: Regional variation in impact on domestic households gaining and losing from a hypothetical transfer of 50% of billing from standing to volumetric charging

Government Office Region	Average annual impact Elec (£)	Average annual impact Gas (£)	Combined average annual impact (£)
East Midlands	0.62	1.88	2.5
Eastern	1.16	0.59	1.75
London	-1.79	-2.45	-4.24
North East	-4.07	-1.57	-5.64
North West & Merseyside	-0.62	0.27	-0.35
Scotland	-0.09	-2.28	-2.37
South East	2.03	1.7	3.73
South West	2.02	1.08	3.1
Wales	5.63	1.23	6.86
West Midlands	-1.97	-0.31	-2.28
Yorkshire and the Humber	-2.78	-0.4	-3.18

Impact on rural customers

- 5.34 The customer archetypes that we use contain a measure of rurality, where a property within the archetype is defined as being in a rural location. This allows us to identify whether customers in rural areas would be more positively or adversely affected by a move from standing to volumetric charging.
- 5.35 Our analysis indicates that rural households would be adversely affected by a move to volumetric charging; if we were to move 50% of charges from standing to volumetric charges, rural households would pay on average £11.34 more for electricity and £2.50 more for gas. This might be explained by rural households being less likely to have access to gas central heating.

Impacts on vulnerable customers; below the poverty line and those receiving disability benefits

- 5.36 Whilst there is an association with income or wealth and consumption of energy, it does not necessarily follow that those households at the lower end of the income distribution have the least need for energy consumption. In particular, some customers with particular types of disability may be high consumers of energy relative to their peers, and other types of vulnerability may also increase demand for energy (for example through increased heating demand). These households would be adversely affected by a move from standing charges to volumetric charging, so it is important that we consider their needs.

Households below the poverty line and receiving disability benefits

5.37 Table 6 below illustrates the modelled changes in bill for households below the poverty line, those in receipt of disability benefits, and both below the poverty line and receiving disability benefits using our central scenario. Our modelling indicates that whilst these changes are relatively small, households on disability benefits would see a modest increase in their electricity bills.

Table 6: Average impact on annual bills on households below poverty line, in receipt of disability benefits, and below poverty line *and* in receipt of disability benefits

Household type	Electricity	Gas
Below poverty line	-0.93	-3.35
In receipt of disability benefits	10.87	-0.46
Below poverty line <i>and</i> in receipt of disability benefits	11.38	-2.24

5.38 However, as with our analysis of the income groups identified above, these average figures disguise a wide range of outcomes for different customer archetypes. Some examples are given below.

- A low-income family household in local authority or housing association property, in receipt of disability benefits or with a Motability disability, who are retired or unoccupied and below the poverty line would see an average reduction in annual bills of £7.28. Our analysis suggests that approximately 575,000 households fit this description.
- However, a middle-income family, couple or single mother receiving disability benefits who are eligible for cold weather payments and warm home discount, on a prepayment meter and with high gas and electricity consumption would see an increase in their bills of £71.09 per annum, based on our central modelling scenario. Our analysis suggests that there could be approximately 3,000 households fitting this description.

5.39 It is clear from this analysis is that the likely impact of any broad-based move from standing to volumetric charges will have complex impacts and is unlikely to benefit any single income group in a uniform manner, even if the equivalisation analysis as set out above suggests that its net impact is likely to be broadly progressive. Some customers who are especially vulnerable may end up paying significantly more per annum on their electricity bills, including customers who can least afford it.

5.40 However, this analysis looks at the impact of a move away from the existing status quo and does not reflect that some customers will have experienced increasing costs as a result of the increase in standing charges, particularly in electricity, seen since the Autumn of 2021.

Impacts on vulnerable customers

- 5.41 Our analysis above provides an indication of how different types of customer would be affected by a hypothetical transfer of charges from standing to volumetric charges.
- 5.42 Whilst the archetypes upon which this analysis is based allows us to identify impacts on groups based on factors which are clear indicators of customer vulnerability (receipt of disability benefits) or which can be indicators that a customer is more likely to be categorised as vulnerable (old age, lower income), it does not offer a definitive indication of customer vulnerability. Our analysis above indicates that a transfer to volumetric charging would produce an increase in cost for customers on disability benefits. Whilst this increase is modest when compared with annual bills for the average customer, it is easy to imagine that it could represent a significant sum to a vulnerable customer who can neither reduce their energy consumption nor increase their income to pay for higher charges.
- 5.43 The archetypes also do not reflect that some vulnerable customers are likely to have particularly complex needs (for instance medical equipment with high energy consumption). Such customers would be unlikely to benefit from a move towards volumetric charges.
- 5.44 A move from standing to volumetric charges would be likely to raise the marginal price of energy consumption and could therefore incentivise a vulnerable customer not to use energy when it was necessary, with potentially severe health effects. It could be dangerous for a diabetic consumer reliant on insulin to turn their refrigerator off, for example.²⁶ Multi-rate tariff contracts with particularly high primary rates in particular would incentivise vulnerable, low income customers to self-disconnect, which could have potentially severe health consequences.

²⁶ See 'The Health Impacts of Cold Homes and Fuel Poverty', at [the-health-impacts-of-cold-homes-and-fuel-poverty.pdf \(instituteofhealththequity.org\)](https://www.instituteofhealththequity.org/wp-content/uploads/2023/01/the-health-impacts-of-cold-homes-and-fuel-poverty.pdf), recovered 1 November 2023

5.45 The difficulty in proactively identifying which customers are vulnerable adds a further element of risk to an un-targeted approach to moving charging to unit rates. Whilst existing tools such as the PSR register and smart meter data can help, it can be difficult to identify those customers who may have complex needs due to vulnerabilities. The impacts of self-disconnection, which may be severe, may not be obvious until serious detriment has materialised.

QUESTION FOR STAKEHOLDERS

Q13: How can we identify the complex needs of vulnerable customers and ensure that they are able to receive tariffs that benefit them the most?

6. Standing charges in the non-domestic retail market

Section summary

In this section we look at standing charges in the non-domestic retail market.

Questions

Q11: What issues affecting standing charges in the non-domestic retail sector should we consider further?

6.1 Non-domestic customers have needs which are more diverse than domestic customers. Their usage profiles can range from very similar to domestic users, to hundreds of thousands of kilowatt hours per year. Non-domestic customers are also not protected by some of the consumer protections enjoyed by domestic customers, including the retail price cap. The lack of a price cap means that non-domestic customers have been particularly adversely affected by the recent wholesale energy crisis. For this reason it is important that they are able to access a suitably diverse range of products that meet their needs.

Network charges and the non-domestic market

6.2 The TCR has changed how charges are applied in the retail non-domestic sector as well as in the domestic sector. Following the TCR, the top-up 'residual' portion of network charges are now charged as a fixed charge, levied as a daily site charge. This contrasts with the previous approaches, that recovered this residual part through unit rates for distribution charges, and through time-of-use charges on usage at certain peak times for transmission charges.

6.3 Whilst all domestic consumers are charged at a single rate per site under the TCR, non-domestic customers are charged under a banded structure made up of fixed transmission and distribution residual charges, based on capacity or consumption at a site. Therefore, non-domestic consumers will see larger daily fixed charges than previously. How these costs are borne by the customer will depend on their commercial relationship with their supplier. Whilst these costs may be charged to the customer as standing charges, it is not guaranteed that they will be.

Suppliers' product offer in the non-domestic market

6.4 Non-domestic products are more diverse than those in the domestic market. Non-domestic contracts are more bespoke than domestic contracts and the terms of

the contract will often be tailored to the needs of the individual business customer. For all non-domestic tariffs, suppliers are able to pass on costs through a mixture of unit rates and standing charges as they see fit, and to set tariffs which will be attractive to their customers and commercially advantageous to them.

- 6.5 One consequence of this is that, unlike in the domestic sector, there is a considerable difference in both unit rates and standing charges in the non-domestic sector. Given the diversity of customers and suppliers in the sector, and different demand profiles and needs of these customers, it might be expected that we would see a wide range of contracts available for customers.
- 6.6 In Ofgem's 2023 Non-Domestic Market Review, we noted that standing charges in the non-domestic sector usually recover fixed costs including metering and certain network charges, while the unit rates are usually made up of costs that vary by usage such as the cost of commodity. Suppliers can differ on where and how they allocate costs such as risk, margins and operating costs. This may be a reason for the variation between suppliers.
- 6.7 Non-domestic customers will be on a deemed rate or a contracted rate. A deemed rate contract is in effect a default contract but does not enjoy the same consumer protection as a default contract in the domestic retail sector (most notably the price cap). Generally speaking, daily standing charges for customers on deemed rates exceed those for contracted rates. This may be due to suppliers having to price in the higher risk and costs to serve for supplier's that is associated with deemed rate customers, for example bad debt, within their standing charge.
- 6.8 There is large variation in the standing charges seen in this sector. Standing charges can range from around 100p per day for smaller sites to over a £1000 per day for the very large business sites. In some cases, there is not a specified standing charge as part of the fixed contract terms, but instead the customer pays 'pass through costs' – in other words, the supplier charges the customer whatever the supplier is billed for their site, for example from the network company. For non-half-hourly consumers in the non-domestic sector, network costs are a significant factor in standing charges for both gas and electricity. Electricity standing charges have been impacted by the TCR in the non-domestic sector. Other costs can be included in standing charges, including costs of the Green Gas Levy and of unidentified gas, and risk premia and costs of bad debt.
- 6.9 Within the non-domestic market, the cost elements which were included in standing charges varied widely across suppliers, and across deemed and

contracted rates. In some instances, suppliers may choose a pricing strategy which charges less for a standing charge (below the level that recovers these fixed costs from the customer) but recoups the remainder from unit rates.

- 6.10 In our recent non-domestic market review,²⁷ many non-domestic customers and organisations representing non-domestic customers told Ofgem that they did not understand the reasons for large increases to their bills, especially standing charges. This indicates a lack of transparency in how a customer's standing charge is calculated, or the reasons for big changes. Ofgem is currently working with suppliers and customer representatives to identify and implement improved transparency.
- 6.11 The heterodox nature of products in the non-domestic market means that to compare standing charges only across contracted terms may not reflect whether a product offers value for money. It may be that a product with high standing charges is compensated for by lower unit prices may (and vice versa). With this in mind, it is not obvious that our focus should be on standing charges when considering how to protect non-domestic consumers.
- 6.12 The one area of price protection in the non-domestic market is through protecting customers on deemed contracts. Standard Licence Condition 7.3 requires that suppliers must take all reasonable steps to ensure that the terms of each of its Deemed Contracts are not unduly onerous.
- 6.13 We have indicated that we will consider standing charges in future assessments of whether non-domestic customers with deemed contracts are being treated fairly. We consulted upon guidance on Standard Licence Condition 7.4 of the Gas and Electricity Supply Licences, and published guidance on 6th November 2023.²⁸ We noted that in our assessment of whether a deemed contract was unduly onerous, we would consider '...the difference between the elements in contracted rates and deemed rates and the reasons for them, including the elements that make up standing charges, unit rates and margins, as relevant.'²⁹

Next steps

²⁷ Non-domestic market review: Findings and policy consultation' at [Non-domestic market review: Findings and policy consultation \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/publications/non-domestic-market-review-findings-and-policy-consultation)

²⁸ See 'Guidance on Deemed Contracts' at <https://www.ofgem.gov.uk/publications/guidance-deemed-contracts>

²⁹ See Ofgem Non-domestic market review, at [Non-domestic market review: Findings and policy consultation \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/publications/non-domestic-market-review-findings-and-policy-consultation), p86

6.14 Our work arising from the non-domestic market review has identified several areas where we will continue our work to protect non-domestic customers. It is our intention to continue our focus on these areas, rather than look further at standing charges in this sector in particular, other than a post-implementation TCR review, as set out earlier.

QUESTION FOR STAKEHOLDERS

Q14: What issues affecting standing charges in the non-domestic retail sector should we consider further?

7. Conclusion and next steps

Why standing charges have increased

- 7.1 This paper has highlighted two broad elements that have contributed to the rise in standing charges in electricity for domestic customers since 2021.
- 7.2 The first of these elements is the impact of supplier failures, principally arising from the wholesale energy crisis of winter 2021/22. This has added costs arising from SoLR levy payments, which have been borne by customers (in electricity) through standing charges. We do not expect to make changes to the way that SoLR Levy costs are recovered on a prospective basis at present, but nor we do not expect to see the need to recover costs on the scale seen following the wholesale energy crisis. However, we should not be complacent, and if we see a need to recover significant costs in future (including for the costs of a SAR), we will consider the impact on consumers through standing charges.
- 7.3 The second element is network charging, and in particular the impact of the Targeted Charging Review. Ultimately, the aim of the TCR was to make network charging better reflect the cost of access to electricity networks now and in the future, and thereby save money for all customers by making networks more efficient. As we have made clear, where these changes will increase standing charges in the electricity market, they bring an equivalent reduction in unit rates on aggregate. We expect that its impact will be more persistent than the impact of the SoLR levy on standing charges, and that it will improve the efficiency of electricity networks.
- 7.4 As we have indicated earlier in the paper, we expect that we will carry out a post-implementation review of the TCR. This will not look specifically at standing charges in the domestic sector but may consider the underlying decisions that have caused standing charges to rise. We will provide further details on this post-implementation review in due course.

Understanding distributional impacts of policy choices

- 7.5 The second part of this paper has highlighted that there are distributional impacts of making changes to standing charges, and that it does not simply follow that lower-income domestic customers would benefit from a reduction in standing charges at the expense of increasing unit rates. Whilst most lower-income households who would benefit from such an intervention, our analysis has identified a cohort of around 1.2 million lower-income households who would experience higher bills were charges to be shifted to volumetric charging. This

cohort is likely to include some customers in vulnerable situations. It is clear that we must exercise care when considering any policy change to ensure that we do not create negative outcomes for large numbers of customers.

- 7.6 However, some form of change may be desirable. Our work on levelisation considers how to produce more equitable outcomes for consumers by altering the distribution of standing charges. Further work may be necessary, working with industry and consumer stakeholders, to examine intervention to protect consumers, especially lower-income consumers, who have experienced detriment as a result of increasing standing charges.
- 7.7 We will consider stakeholder feedback to this discussion paper, along with engagement with stakeholders, before deciding next steps on policy.

Improving customer choice and protecting consumers

- 7.8 One solution to the issue of standing charges could be for suppliers to issue a greater range of tariffs to customers, and to assist their customers in finding the right tariff for them. As part of the engagement with suppliers that will follow the publication of this discussion paper, we expect to grow our understanding of how we can make sure that suppliers are offering a range of tariffs that meet their customers' needs, and what (if any) obstacles currently prevent them from doing this. As smart meters become more universal across the domestic retail market, it should be easier for suppliers to proactively identify whether their customers could benefit from different types of tariff offering and work to make these available.
- 7.9 As we have identified earlier in this document, the remedies from the CMA's market investigation in 2016 intervened in tariff design with the aim of improving choice for consumers. However, this increase choice has not materialised. Whilst the retail energy market in 2023 looks markedly different from that of 2016, the time is right to look at whether the market is providing customers with a range and variety of products which truly meets its needs, and if not, what can be done to remedy this.

Next steps

- 7.10 Throughout this discussion paper we have provided examples of questions which we consider to be relevant to the issue of standing charges in domestic and non-domestic energy markets, and which we believe would help inform any future policy in this area, should we decide to make changes. We welcome the views of

stakeholders on any or all of these questions, or indeed any of the other issues that are raised by the paper.

- 7.11 Following publication of this paper, we will be taking the opportunity to engage directly with stakeholders in the winter of 2023/24, to allow us to examine some of the issues discussed in this paper in more detail. We will share details of with shareholders in due course.

Appendices

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Appendix 1 – Summary of Call for Input questions

This annex summarises the questions in the main document. Stakeholders are invited to provide responses to some or all of these questions, or any of the issues raised in the Discussion Paper.

3. Standing charges, network charges and the price cap

Q1: What are the barriers to suppliers using the existing flexibility under the price cap?

Q2: Why are suppliers not innovating on standing charges for tariffs not covered by the price cap?

Q3: What changes could Ofgem make to improve provision for lower standing charges under the cap.?

Q4: As a result of TCR and changes to the recovery of residual costs, domestic consumers with very low consumption now bear a share of fixed network costs which is more in line with the cost of maintaining access to gas and electricity networks. Is this fair? Should more be done to shield these customers from these costs?

Q5: What are the reasons for regional variations in electricity standing charges?

Q6: Can we learn from other sectors about how to improve suppliers' tariff offering in the UK energy market?

5. Standing charges and the domestic retail market

Q7: Why do so few suppliers offer multi-tier or zero standing charge tariffs to their customers?

Q8: Why are zero standing charge tariffs no longer offered in the market, with the exceptions cited in this paper?

Q9: What measures could Ofgem take to improve the range of tariffs available to domestic retail customers?

Q10: Why do no suppliers offer rising block tariff products at present? Would these products offer benefits to consumers?

Q11: How significant an impact do standing charges have on customers' incentives to use energy efficiently? What evidence can you provide that this is the case?

Q12: Are there any forms of intervention in standing charges that Ofgem might consider that would minimise the risk of producing negative outcomes for some customers?

Q13: How can we identify the complex needs of vulnerable customers and ensure that they are able to receive tariffs that benefit them the most?

6. Standing charges in the non-domestic retail market

Q14: What issues affecting standing charges in the non-domestic retail sector should we consider further?

