The voice of the energy industry

Energy UK response to Ofgem's Cost Allocation Review Call for Input

24/09/2025

About Energy UK

Energy UK is the trade association for the energy industry, representing companies investing billions of pounds to secure our country's current and future energy needs.

From growing start-ups to major electricity generators, grid and infrastructure developers, and energy suppliers, our members are driving change across power, heat, transport, and flexibility.

We provide a collective voice for the sector working with governments, regulators, charities and other organisations to provide crucial insight that shapes policy, offers solutions and promotes best practice.

Our broad view across the whole system supports evidence-based positions which are not tied to particular technologies, and are focused on delivering strategic benefits for people, businesses and the economy.

We champion initiatives such as our Vulnerability Commitment, which pushes suppliers to go beyond regulation to support customers with additional needs, and TIDE, the industry's drive for greater inclusion and diversity. Through our Young Energy Professionals Forum, we support the development of future leaders. We are equally committed to our team and are proud to be recognised as a 'Gold' Investors in People employer.

Executive Summary

We welcome Ofgem's acknowledgement that the current allocation of costs leads to some unwanted consequences and may not be optimal for delivering an efficient market under a clean power system.

This review should prioritise the conditions for energy retail to develop and offer products that send cost-reflective, forward-looking signals that drive system efficiency, lower carbon emissions, and enable better consumer outcomes. However, we are concerned that this does not appear to be the current focus of the review.

Energy UK has three key concerns with the review's direction:

- Ofgem will be unable to deliver the necessary system change, which requires Government to play a central role;

- A short-term and narrow focus on social acceptability of the standing charge-unit rate balance;
- The lack of consideration of the role of competition and consumer engagement in delivering system efficiency.

Perhaps the most concerning element is the scope for prescriptive generic tariff obligations on suppliers, such as rising or falling block tariffs or zero standing charge tariffs. Without nuance and careful tailoring, consumers, including those in vulnerable circumstances, are likely to lose out, as in Ofgem's proposed mandation and introduction of low standing charge options before the conclusion of this review. As Ofgem evidence suggests, simply increasing unit rates could make 2.3 million low-income households worse off[1]. It will also likely damage the competitiveness of existing market tariff propositions and limit engagement with low-carbon technologies such as heat pumps[2].

Ofgem should, instead, focus on the issues that will fundamentally shape the investment signals, market dynamics and consumer engagement needed to deliver an efficient energy market under a clean power system.

This entails developing a cost allocation regime that is appropriate for the evolving nature of the energy system, which means bringing down bills over time by allocating costs in such a way that drives consumer engagement with flexibility and improved customer outcomes. This is, in part, through ensuring network charging reflects consumers' actual additional cost to the system, simultaneously enabling rewards for consumer behaviours that lower system costs and emissions.

Transparent consideration should also be given to other levers available to the Government and Ofgem to drive consumer engagement with energy. For example, modelling of the anticipated evolution of policy costs on the bill and the extent they will remain on metered consumption is critical to anticipating the impact of any changes to network charging. We encourage the production of a complete roadmap of current policy workstreams that could impact cost allocation.

This review is only part of what should be considered a critical mission led by the Government to ensure the public and businesses can see the energy transition delivering for them. This requires incentives to decarbonise and lower their energy bill, for example, by moving policy costs away from electricity, and to assess how targeted bill support can ensure vulnerable consumers are protected in the energy transition. If policy costs remain on electricity bills, it will be even more imperative that the outcomes of the cost allocation review support DESNZ's work on enabling

[1] Ofgem (2024) Standing charges: domestic retail options

[2] Illustrative analysis by Frontier Economics presented at the Energy UK event *How Clean Heat Can Bring Down Bills* (18th September 2025) demonstrated how redistributing costs from the electricity standing charge to the unit rate could, all else equal, have an adverse impact on the financial incentives for many households to take up a heat pump.

consumer flexibility, as high electricity levies will remain an issue even if network charging is reformed.

During the transition, consumer experiences are likely to become more diverse. At one end of the spectrum, we may see highly engaged households with full electrification actively participating in flexibility services. At the other end, consumers who can't easily adopt new technologies, own a vehicle, or live in homes suitable for heat pump installation. The Government, supported by Ofgem, should focus on enabling a market for inclusive smart solutions so as many customers as practicable can benefit directly[3].

Energy suppliers have a critical role in offering solutions that work for consumers around the charges they recover on behalf of the energy system. To deliver a fair system, Ofgem needs to propose options that facilitate the market to:

- improve consumers' understanding of charges, knowing what behaviours can save them money;
- encourage consumers to behave in a manner that will save them money;
- ensure that vulnerable customers' usage will lead to good outcomes, either saving them money or being protected from higher costs.

Ofgem should apply the following principles to determine how to take the review forward:

- Charges should be cost reflective, rewarding behaviour that lowers system costs and emissions through a competitive and investable retail market.
- Improve transparency and certainty of upcoming and future costs for the entire market. Non-commodity cost uncertainty for suppliers adds additional costs to consumers through risk premia being added to contracts. Investment in energy assets is also dependent on clarity over long-term costs. Therefore, cost transparency and cost certainty should be a priority.
- Cost allocation should be as simple as is practicable; complexity should be avoided without strong justification and in full consideration of the important role of consumer engagement and behaviour change.
- Avoid options that would distort the market, reduce efficiency or damage investability and competition.
- Leave to the Government to consider any cost allocation options that require significant legislative change.

If you have any questions or would like to discuss this response in more detail, please so not hesitate to contact Energy UK.

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[3] Energy Systems Catapult (2025) Inclusive Smart Solutions

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Consultation Response

Standing charges

Energy UK has seen no evidence that shifting standing charges to unit rates is perceived as more important for current consumers than bringing down bills and tackling Net Zero. Doing so would likely increase energy bills and reduce the incentive to adopt low-carbon technologies. It also risks making it difficult for suppliers to ensure appropriate cost recovery of the charges passed on to them by network operators. It is, therefore, not an appropriate focus of this review, so options A2 and A3 should be ruled out.

One of the biggest issues with energy bills is the impact on low-income and vulnerable customers who end up paying proportionally more as a percentage of their income. Altering the structure of standing charges is not an effective route to deal with this challenge. Addressing this issue requires targeted bill support. The significant complexity entailed by introducing income or wealth based standing charges and the unintended consequences it could have for price signals are both compelling reasons to separate the issue of cost shielding to support vulnerable customers from the principles of network charging. As a result, D1 and D2 should not be further considered.

Further, given Ofgem's public support for enhanced bill support and the recognition of data's role in its vulnerability strategy and income-related interventions, we would expect the regulator to be more proactive in convening routes to better data access to the Government and key stakeholder data for the energy retail market to establish channels for targeted support.

Consumer engagement with cost allocation

Energy retail, including aggregators and intermediaries, represents the primary way that consumers will engage with their energy options.

Ofgem should, therefore, explicitly focus on the scope for markets to deliver products and services that provide transparency, control, value and fairness to customers.

This means ensuring that customers pay and are aware that they will pay for the costs they bring to the system, and are rewarded for actions that will reduce system costs. This may require consideration of the balance of standing charges and unit rates that are passed to suppliers alongside other costs, and how they provide the role of overall temporal or spatial price signals. However, this balance must also reflect the cost recovery risk for energy suppliers who are expected to increasingly pass through cost signals to consumers to deliver the benefits case for market-wide half-hourly settlement.

There is a significant contrast between the DESNZ consultation on consumer-led flexibility and Ofgem's options in the review. Ofgem appears to be considering prescribing tariffs to customers that will only deaden and fail to optimise price signals

relative to what a market-based approach could offer (assuming some inevitable tailoring and dynamism linked to reduced system cost for different customers).

The overall strategy to deliver consumer-led flexibility, which DESNZ appears keen to drive, is still at an early-stage, but should include a wider range of considerations for building consumer trust and ultimately engagement in energy. This is an issue beyond standing charges, and which includes the ongoing role of the price cap and extends beyond rational choice reaction to price signals. How consumers feel about energy suppliers is clearly linked to the cost of bills, and how they feel about energy costs is clearly shaped by factors beyond the standing charge, such as the communications they receive about the sector and regarding energy flexibility.

It is important that Ofgem maintains a collaborative and constructive tone that is applied consistently, with improved clarity on the obligations of suppliers, which should be a key aspect of Ofgem's Consumer Confidence work. These are crucial elements of Ofgem's strategy to support better consumer comprehension and improved perception of energy cost efficiency.

As a result, this review, in the context of a wider strategy to drive consumer-led flexibility and bring down bills, should focus on the standing charge and unit rate balance, and the degree of temporal and locational signals that are provided to suppliers, in such a way as to enable scope to tailor products and services. This will be more effective than expecting centralised policy prescription of products to achieve an optimal outcome. Options B and C are broadly appropriate to examine in more detail where they allow the retail market to retain the capability to test and implement different offerings.

Network charging and the changing energy system

As consumption profiles for domestic and non-domestic consumers evolve and more consumers adopt flexible electric vehicle (EV) chargers, home batteries, heat pumps (HPs), and rooftop solar panels, the variety of consumer profiles will evolve. As such, the current approach based on consumption bands also needs to evolve. The current regime, based largely on residual charges, will not send an appropriate market signal to Transmission Operators (TOs) or Distribution Network Operators (DNOs) as to the need for reinforcement, nor to consumers to reduce their peak consumption where possible.

The Targeted Charging Review (TCR) was pursued for the right reasons. Large, flexible consumers avoiding peak charging periods, shifting most costs onto inflexible consumers, and thus avoiding paying their incremental contribution to system cost, was not cost-reflective or fair.

However, it has involved trade-offs. As the international case studies Ofgem presents reflect, in an energy system with a high and rising penetration of behind-the-meter consumption as well as the use of time-of-use (ToU) tariffs or demand-side response (DSR) to avoid peak pricing periods, the current system of relying heavily on residual

charges linked to capacity risks disincentivising flexibility through dampening the price signal.

Similar issues have emerged in other markets, notably Spain, where the Government tried to address the issue of consumers with rooftop solar panels avoiding network charges by implementing the controversial 'solar tax' (*impuesto solar*) to ensure network costs were recovered. This tax was subsequently removed in 2018.

The current system risks undermining the cost reflectivity of network charging, because those consumers who reduce their peak consumption, and ultimately reduce the need for networks and generation to be expanded, would end up paying more than their fair share of system costs. The reverse, returning to a system that existed prior to the TCR, would also present issues of cost reflectivity, as those that do add incremental costs to the system could avoid paying them. It is for this reason that ensuring residual charges recover sunk system costs is so important, something that may be supported by the ongoing work to shift the basis of charging nodes as part of CMP 423, which should help to some extent ensure residual charges are actually aimed at recovering sunk costs.

Given the direction of travel, there is a need for network charging to appropriately apportion costs to consumers who contribute to the expected acceleration of incremental buildout, while rewarding consumers who help limit the necessary scale of buildout, through forward-looking signals that limit peak consumption, especially through the use of flexible and behind-the-meter consumption. It will also be important to reward consumers who "turn up" demand when it is helpful to the system.

Energy UK would therefore encourage Ofgem to explore using an *ex ante* subscription-based peak capacity charge for consumers, similar to what is currently used in France. Unlike in France, these charges could vary by location, ideally being lower the closer demand is to the main sources of generation. This system would favour consumers who can engage in flexible consumption to reduce their peak consumption (not just shift it) over those who cannot.

If adopted as an *ex ante* subscription model based on contracted capacity, as is done in France, it may be more cost-reflective and appropriately forward-looking than the Triad-based system before the TCR, and would provide incentives for consumers to smooth their consumption, reducing peaks. The distributional impacts on inflexible consumers who do not, or cannot, take up flexible consumption could and should then be addressed using targeted policy measures outside of network charging. There are potential challenges and complexities to making this model work, including smart meter uptake and consumer understanding.

The benefit of capacity charging, based on either contractual power or actual peak demand, is that it allows recovery of fixed network costs better than any other mechanism. This is because peak load demand is the largest driver of an individual's contribution to network cost.

Other countries appear to be looking to shift to forward-looking, peak capacity-based charging as they seek to build their electricity networks to meet rising demand for electricity. Key examples besides France include Norway, Italy, the Netherlands, and, to some extent, Spain and Slovakia, which use a mixture of capacity and volumetric charges.

To enable flexible end use that benefits the system, including increasing demand when there is excess renewable supply, for example, some fleet operators who aggregate electric vehicles or thermal storage applications in industry, it may be appropriate to consider exempting some non-domestic consumers from capacity charges. These customers would need to sign up for non-firm access agreements with their network operator and allow them to manage their peak consumption, ensuring no consumption during peak or constrained periods.

If their peak consumption is managed such that they are never consuming during hours where local or national supply is below demand, and their access is non-firm and thus no system reinforcement is required, it would be fair to suggest that the incremental addition to the system investment in the network required to meet their demand is zero. The main costs to be recovered would be operational costs (mainly to cover system losses) and some residual costs.

Separate metering for the different arrangements could enable end consumers to use part of their consumption flexibly in this way for suitable loads, even if they are unable to shift all of their usage. To avoid large, flexible consumers being able to avoid paying their share of charges by avoiding Triads, as was the case before the TCR, this model should not be applied more widely than those content to have their consumption managed in a way that ensures no incremental investment in the system is needed.

Alternatively, Ofgem could explore creating more residual charging bands for non-domestic consumers and introducing bands for domestic customers, who are currently all charged the same. As consumption patterns change, and more consumers use flexibility measures and generate power to meet their own consumption, ensuring appropriate, cost-reflective network charging will no longer be simply a question of the size of the local connection, or whether the consumer is domestic. Ofgem could consider creating a greater number of charging bands based on voltage level and peak consumption levels. Creating profiles for these consumption bands will be helped by the increased granularity of data from initiatives such as the Data Sharing Infrastructure (DSI) and Flexibility Asset Register (FAR).

This effort would need to be paired with efforts to make it easier for consumers to change their charging band and subsequently benefit from reducing residual charges, something made difficult by certain statutory regulations under the Distribution Connection and Use of System Agreement (DCUSA).

Even with improved data, this approach may prove more technically difficult than our preferred approach of using peak capacity-based charges. Further, such an

approach would be more complex, especially for suppliers considering how to design their tariffs, and could lead to “cliff edges” between one charging band and another.

Energy UK does not encourage Ofgem to consider volume-based charges, including those that vary with time of use, at this time. While such a system might encourage consumers to avoid periods of congestion, at present, it is difficult to link such charges to the incremental cost of a consumer to the system. Ideally, volumetric charges should be forward-looking, should recover the cost of reinforcement and system losses and should enable congestion management.

Separating this from the fixed costs of incremental buildout is complex and would likely require much more granular, open-access network and consumer data. This may be possible in the future through completion of the smart meter rollout and the implementation of measures including the Data Sharing Infrastructure (DSI), though such granular data is not expected to be made widely available for some years.

In the immediate term, Ofgem and NESO should prioritise enabling flexibility markets in Great Britain (GB) to manage periods of constraint, building on the successes of the Demand Flexibility Service (DFS) and Locational Constraints Market (LCM). Efforts should be made to ensure these price signals are strong enough for consumers to respond to.

Nonetheless, Ofgem should consider a shift to more ToU volumetric charges to send signals to avoid constraints if, sometime in the future, wholesale costs fall to such a level that most consumers’ bills are made up of network charges and policy costs, and therefore send an insufficient market signal to consumers to reduce their peak consumption even with a more optimised DFS and LCM. Indeed, it is because other markets worldwide, such as Spain and Slovakia, do not have flexibility markets designed to sufficiently incentivise consumers to flexibly consume that they are relying increasingly on ToU volumetric network charges to drive flexible behaviour. Ofgem should therefore consider in the future the need for ToU volumetric charges should the DFS and LCM continue to provide insufficient flexible consumption incentives.

In the near term, Ofgem should ensure that, as energy consumption patterns evolve and data on how consumers use the system improves, network charges are apportioned more appropriately to reflect how each consumer’s behaviour adds to the incremental cost of the system. The appropriate time to do this may be if peak consumption begins to significantly shift from the current morning and evening peaks to times when system costs are lowest due to high renewable energy output.

Wider coordination

Regarding other policy workstreams, Ofgem must coordinate the cost allocation review with the intention of making demand-side network charges more locational. Efforts are already, rightly, underway to reintroduce locational demand signals as part of CMP 440. However, the reform here mainly pertains to locational charges when it

is residual charges, which have no locational element, that make up the overwhelming majority (97%) of demand-side transmission charges.

Therefore, whether Ofgem chooses to move to a peak capacity-based charging system, retain a system based on residual charges, or choose another charging regime, the same effort to make charges more locational should apply to the wider network charge ultimately felt by customers.

Ofgem must also consider system costs, which do not appear clearly in the final bill, namely, connection charges. The lack of standardisation of connection charging methods across GB is a serious issue, with costs varying widely from one region to another, even when working with the same DNO. Ofgem should urgently look to address this to ensure an equitable and cost-reflective approach across GB.

It is also worth considering this in the context of the recent update to Review of Electricity Market Arrangements (REMA), as the Government may end up preferring the use of connection charges to send locational signals over transmission charges. Both these issues should be considered as part of this review.

Questions

Question 1: What other examples or evidence from relevant sectors or international energy markets should we consider as part of our review?

Energy UK encourages Ofgem to examine the approach to capacity-based network charging in France based on a subscription, *ex ante* model. Other approaches to capacity-based charging can be seen in Norway and the Netherlands.

A mixed approach to volumetric and capacity-based network charging can be seen in Slovakia and Spain, and could prove informative should Ofgem agree that additional, forward-looking congestion management signals beyond the DFS and LCM are needed in the future.

An example of dynamic volumetric network charging, making use of smart meter data, is currently being piloted in Switzerland by the energy utility, Group E, through their 'Vario' tariff. Such an approach could prove informative to how dynamic volume charges could be optimised for cost reflectivity and recovery when granular consumer and system data is available.

For case studies of what to avoid, Energy UK recommends examining the use of the 'solar tax' in Spain before its removal in 2018. This was Spain's attempt to ensure cost recovery for network costs that were being avoided by consumers who were increasingly making use of behind-the-meter network charges. It was following this that Spain made increasing use of capacity-based charges to amend this shortcoming while maintaining an incentive for consumers to limit their peak system use through behind-the-meter consumption.

Italy is also a good case study for why block tariffs are an inappropriate structure to achieve progressive economic goals. From the 1970s until around 2016, Italy used a rising block network charging structure for consumers. The assumption was that richer or wealthier consumers consumed more electricity and so should pay for a greater share of the system. It was established following a series of studies by the regulator during the 2010s that wealth or income was not well correlated with levels of energy consumption, especially for certain industries and vulnerable consumers. Italy has, since 2016, moved away from the rising block tariff structure to one based on ToU capacity charges.

Question 2: What options for amending domestic cost allocation and recovery should we explore in more detail and why? What options should we rule out at this stage and why?

Energy UK would advise exploring *ex ante* peak capacity-based charging and, potentially for later reform, more granular ToU volumetric charges.

Ofgem should be clearer in this section when talking about what policy options it is referring to. Ofgem should not be considering dictating to retailers the balance of

standing charges and unit rates in their charges. This is for suppliers to consider. Ofgem should instead be considering the statutory regulations governing the balance of volumetric, capacity and residual charges set by network operators that are passed on to retailers.

Ofgem should, as one alternative, consider creating a greater number of charging bands, including for domestic consumers, for residual charges to reflect the evolving nature of consumer archetypes. However, this should be a secondary option given the complexity of doing this and the fact that residual charges, at their core, are backwards-looking charges meant to recover sunk costs. They are not, in principle, meant to send market signals.

Ofgem should rule out mandating block tariffs. These measures are distortive and potentially dissuade consumers from taking up low-carbon technologies.

Ofgem should also rule out income or wealth-based charges. It is the purpose of network charges to cost-reflectively recover the cost of the energy system by those who add to its incremental build-out and use. It is not for these charges to facilitate progressive economic policy. That is for targeted fiscal policy or purpose-built industry schemes to achieve.

There may be some exceptional circumstances where fiscal support or purpose-built schemes to aid vulnerable consumers or strategic industries are impractical. In these situations, carve-outs and socialisation of network charges, like those used for Energy Intensive Industries (EIIs) or perhaps public EV chargers (as is being explored through DCP 420) are the most practical way to provide targeted support. However, such measures should be the exception, not the rule.

Question 3: How would changes to the underlying rules and approaches for allocating and recovering system-wide costs be expected to translate into the tariffs offered by suppliers?

Any costs that are put into volumetric charges will be passed through as unit rates; anything that is a fixed cost, like residual charges or capacity-based charges, will likely be passed through to standing charges. It is simpler for most suppliers to do this as one is a fixed cost and the other is variable.

There are examples of some suppliers passing through costs in a hybrid fashion, but this requires sophisticated software and is thus something only a minority of suppliers do.

Question 4: What options for amending non-domestic cost allocation and recovery should we explore in more detail and why? What options should we rule out at this stage and why?

Similar to our answer to question 2, Ofgem should consider *ex ante* peak capacity-based charging and potentially, for later reform, more granular ToU volumetric charges. As one alternative, Ofgem could consider creating a greater number of charging bands to reflect the changing nature of non-domestic consumption.

Also, similar to question 2, Ofgem should rule out mandating block tariffs and wealth or income-based charges.

One addition to the recommendations in our answer to question 2 is the varying of capacity-based charges by location, with them getting lower the closer some non-domestic consumers are to generation. This is perhaps not appropriate for domestic consumers, but could prove useful for large, strategic demand sources like data centres to be incentivised to locate near high generation zones in order to reduce system constraints.

Question 5: Should we consider alternative methods for splitting network costs between domestic and non-domestic consumers? If so, what methods should we consider and why would these alternative methods benefit consumers?

No, however, as mentioned above, Ofgem could potentially explore creating more charging bands for domestic consumers, as is done for non-domestic consumers However, this could prove complex to implement in practice for suppliers, given the nature of the price cap, and so Ofgem should consider this very carefully.

Question 6: What do you think of the five criteria we have proposed to assess and the descriptions we have provided for their scope? How should we balance the trade-offs between these?

The efficient recovery of system costs in a cost-reflective manner should be the principal criterion, above all others, that guides how network charging is set.

Question 7: What evidence should inform our options assessment? You are encouraged to share information, analysis and evidence with Ofgem to inform our assessment.

Government direction and democratic accountability should determine the trade-offs that inform the options assessment. It is not for Ofgem to decide this *de facto*.

That being said, Energy UK would recommend three studies:

1. A review of network charging in other countries from 2021 by Delta-EE
2. A study of various network charging options that European nations can consider in order to enable the energy transition by the Climate Action Network

3. A study by FTI looking at how European nations can make network charging more cost reflective, encourage flexible energy use and limit negative distributional impacts.

Energy UK would like to clarify that we do not necessarily endorse the policy options and recommendations of any of these reports, though they provide informative international case studies and research that Ofgem should find helpful.

Question 8: What are the main trade-offs between our proposed assessment criteria? What are the main positive interactions?

Ofgem have largely identified the appropriate areas of trade-off in the consultation document.

Cost reflectiveness, economic growth and Net Zero do currently involve a trade-off, but endeavouring to improve cost reflectiveness should enable economic growth and decarbonisation policy.

Question 9: Do you agree we should consider impacts up to 2035?

System investments last for decades, so we would advise that impacts should at least be assessed out to 2050.