



Third Party Charges

The term third-party charges—also known as non-energy or pass-through charges—describes the costs faced by gas and electricity suppliers that are outside their direct control.

As the costs of government policies and network costs have both increased in recent years, so have third-party charges. This has served as an upward pressure on businesses' energy bills, as these charges are passed through to consumers.

What is a third-party charge?

Third-party charges are those costs on an energy bill that suppliers cannot control.

They include the charges that are levied by network companies on energy suppliers for their customers' use of the transmission and distribution networks.

They also include the costs levied on suppliers by the government as a means of funding its renewables, energy security, and energy efficiency policies.

What are the main third-party charges?

The descriptions below detail the third-party charges paid by business energy users. They are broken down into network and policy charges, as well as whether they affect electricity and/or gas users and some indication of the types of businesses that they are likely to impact.

Networks charges

- **Transmission networks:** All consumers of electricity or gas are deemed to make use of the respective transmission networks for the fuels. Transmission Network Use of System (TNUoS) charges for electricity are levied on suppliers by National Grid Electricity Transmission (NGET). For gas, National Transmission System (NTS) charges are levied on suppliers by National Grid Gas (NGG);
- **Distribution networks:** All but a handful of the very largest consumers pay distribution charges. There are 14 regional electricity Distribution Network Operators (DNOs) levying Distribution Use of System (DUoS) charges. Five regional gas Distribution Networks (DNs) levy Local Distribution Zone (LDZ) charges. The distribution network is the link between the large-scale transmission system and the actual sites of energy users;
- **Balancing:** System operator National Grid charges to cover the costs it incurs in real time of managing power flows on the transmission system. This is to ensure demand and supply remains matched. These charges are calculated for every half-hour settlement period. The costs of balancing the gas transmission network are bundled into NTS charges;
- **Losses:** there is a separate cost to suppliers for the energy that is lost in passing through the networks. These costs are known as shrinkage for gas and are included in the transmission and distribution charging. In electricity, losses are borne by suppliers purchasing extra energy on the wholesale market. Therefore, they are not technically an electricity third-party charge.

In this edition

- *What is a third-party charge?*
- *What are the main third-party charges?*
- *How are businesses charged?*
- *The future direction of third-party charges*



Policy charges

- **Renewables Obligation (RO) (electricity):** This is based on the requirement faced by electricity suppliers to source a proportion of their electricity each year from large-scale renewables generation, in return for which they receive Renewables Obligation Certificates (Rocs). Suppliers conventionally spread the cost of purchasing Rocs across all the electricity that they supply to their customers;
- **Feed-in Tariffs (FiTs) (electricity):** The FiT is a government-mandated scheme that offers premium prices to certain small-scale generators (up to 5MW), such as solar panel owners, for their output. Scheme costs are recovered by a levy on suppliers that is linked to the volume of electricity they sell to all customers;
- **Contracts for Difference (CfD) (electricity):** This covers the cost of contracts awarded to generators that guarantee them a price for every unit of power they generate. The cost of the difference between the wholesale market price and the guaranteed price (known as the strike-price) is ultimately borne by energy users;
- **Capacity Market (electricity):** This recovers the cost of auctions held for generators and demand-side response to guarantee energy security by providing capacity over coming winters. Costs are recovered from suppliers based on consumption over winter peak periods;
- **Climate Change Levy (CCL) (electricity and gas):** This is a tax levied on most non-domestic electricity and gas consumption and is payable by suppliers to HMRC. Suppliers charge the CCL at a rate appropriate for each non-domestic user after taking account of a complex range of abatements and exemptions;
- **Energy Company Obligation (ECO) (electricity and gas):** This is an obligation on larger suppliers (with greater than 250,000 accounts) to invest in energy efficiency schemes for household energy users. Obligated suppliers normally recover the cost of the scheme through domestic prices, so this charge conventionally does not affect business energy users—but it may be a factor for housing associations;
- **Warm Homes Discount (WHD) (electricity and gas):** Larger energy suppliers (those with more than 250,000 accounts) must offer special terms and rebates to vulnerable customers. Similar to ECO, costs incurred are conventionally recovered across all domestic customers.

Estimated average impact of policies on gas and electricity bills paid by small-sized business users

Real 2014 prices, £	2014	2020	2030 ^{est} (See footnote)
Average gas bill without policies	49,000	52,000	62,000
Average gas bill with policies	52,000	55,000	64,000
Impact of policies on average gas bill	3,000 6%	3,000 5%	3,000 4%
Average electricity bill without policies	22,000	24,000	27,000
Average electricity bill with policies	27,000	34,000	41,000
Impact of policies on average electricity bill	5,000 21%	10,000 40%	14,000 50%
Average energy bill without policies	71,000	77,000	89,000
Average energy bill with policies	79,000	89,000	105,000
Impact of policies on average energy (gas plus electricity) bill	8,000 11%	13,000 16%	16,000 18%

The impact of these policy costs is measured and forecast by the government.

The most recent forecast was released in late 2014, and while there have been some policy changes since, this still provides a useful forecast of rising costs (see graph right).

A further update is likely to be published later in 2016.

Source: Government



How are businesses charged?

There are two main different ways in which third-party charges are applied to business energy bills.

The first is “All Inclusive” fixed-price tariffs, where the cost to the customer will be the same throughout the contract, include a premium to cover the supplier in the event of an unexpected rise in third party costs.

The alternative is “pass through” contracts, which see third-party charges billed to the customer at the rate faced by the supplier.

Typically, the amount of third-party charges a business energy supplier builds into a quote is not fixed, but based on forecasted rates. Each quote will represent these charges in a different way and the amount will vary depending on the supplier.

The future direction of third party charges

The wholesale prices of power and gas have fallen significantly over the past year. But third-party charges are climbing. This means that these charges make up an increasingly large proportion of the energy bills of both households and businesses.

Forecasts by consultants Cornwall Energy suggest that networks, renewables, and energy efficiency charges will make up more than half of final electricity bills in 2016-17 for some small and large businesses.

Both network and policy costs are set on an upwards trajectory. Renewables deployment will increase over the coming years, so the cost of supporting this for businesses, through measures such as the RO and FiTs, will continue to grow.

However, the government’s recent cuts to renewables support schemes does make it likely that the growth seen in renewables charges will slow down over the next couple of years. The RO will close to new capacity from 2017, and the government is highly unlikely to provide any further funding for CfD projects that become operational before 2021.

System operator National Grid published its final TNUoS tariffs for 2016-17 at the end of January. The overall trend is for charges to rise next year. This reflects a greater percentage of National Grid's allowed revenue being recovered from demand, as opposed to generation, and reduced peak demand driving up per unit costs.

Another significant change that will affect third-party charges will be the upcoming exemption for energy intensive industries from the costs of supporting renewables through the RO, FiTs and CfDs. This exemption means the charging base for such measures will be narrowed and costs increased for non-exempt businesses.

Indeed, Cornwall Energy estimates that this change could see the cost component of electricity bills related to renewable power subsidies increase by as much as 7%. There have been some concerns among market stakeholders that an increase of this proportion could lead to suppliers re-opening contracts to recover costs from their customers, even with those products that are claimed to be completely fixed.

To discuss anything in this newsletter, or for any more general enquiries, please contact your Account Manager, or:

- Email: enquiries@monarchpartnership.co.uk
- Phone: 020 8835 3535
- www.monarchpartnership.co.uk