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Your ref

Our Ref

Date

5th May 2017

Contact / Extension

Paul McGimpsey
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Dear Judith,

TARGETED CHARGING REVIEW: A CONSULTATION

I am writing on behalf of SP Energy Networks (SPEN), representing the distribution licensees of SP Distribution plc and SP Manweb plc. We welcome the opportunity to respond to Ofgem's Targeted Charging Review (TCR) consultation.

We broadly support the proposed TCR, which distinguishes between 'forward-looking' network charges and 'residual' charges and proposes a Significant Code Review (SCR) to consider changes to:

- residual charges;
- charging arrangements for embedded generation (EG); and
- the timing of any changes.

Whilst supportive of Ofgem's TCR approach, we consider it vital that a comprehensive review of the high level of residual network charges is carried out alongside this work to ensure that customers pay for the costs they drive on the network in a fair and proportionate manner.

Our responses to the consultation are attached. We would welcome the opportunity to discuss further with you the points raised.

Yours sincerely,

Gerard Boyd



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TARGETED CHARGING REVIEW: SPEN CONSULTATION RESPONSES

CHAPTER 2: WHY WE PROPOSE TO REVIEW RESIDUAL NETWORK CHARGES

Question 1: Do you agree that the potential for residual charges to fall increasingly on groups of consumers who are less able to take action than others who are connected to the system, is something we should address?

The consultation distinguishes between ‘forward-looking’ network charges that are designed to incentivise the efficient use of the network (and reflect network users’ impact on current and future network costs) and ‘residual’ charges that are set to ensure that the network’s efficient costs can be covered, after other charges have been levied.

You refer to residual charges as charges that do not specifically relate to particular network costs, for distribution this is not correct. There are various costs that could be further identified, as not all costs are allocated within the 500MW model. This is currently being reviewed within the CDCM/EDCM review and could potentially reduce the level of residual charges.

In the context of transmission networks, we would note that residual charges account for a high proportion of the total charges. Cost reflectivity is a key principle for network charging and we believe it is important that the level of residual charges are also reviewed, in a manner similar to the work being carried out at distribution, to check that they are set at an appropriate level. The principles of allocated residual costs should be reviewed alongside the work of the TCR which will ensure that customers pay for the costs they drive on the network in a fair and proportionate manner.

Question 2: If so, why do you think, or do not think, action is needed?

There will always be an element of residual charges as network companies recover their allowed revenue and we agree that there is a need to review the basis for this to ensure charges are levied on the appropriate consumer groups and that they contribute fairly. We recognise that the industry has undergone significant change in recent years and as a result some customers have been able to react to developments and avoid certain network costs. Residual costs apply to all those connected to the network, regardless of how they use it.

Question 3: We are proposing to look at residual charges as a Significant Code Review. Are there any elements of residual charges that you think should be addressed more urgently? Please say why.

Whilst we recognise that the review of how residual charges are applied can be addressed separately, we believe a review of the level of residual charges, identifying the elements that make up this charge, should be carried out alongside this work.

CHAPTER 4 - EXPERIENCE IN OTHER COUNTRIES

Question 4: Are there elements of the approaches in other countries that you think could be appropriate for GB residual charges?

Whilst we believe there is value to be gained from other countries’ experiences, further detail is required regarding the extent to which the make-up of network costs is known and how these have been allocated across the residual and forward looking elements of the tariffs.

In GB it is worth noting that the DCMF conducted an initial review of the CDCM which highlighted areas for further development including the introduction of higher ratios of fixed/capacity based charges versus higher unit rates. An initial report was formally submitted to Ofgem on 29 Nov 2016 and work is ongoing to assess options.

Question 5: Are there other approaches that you know about from other jurisdictions, that you think offer relevant lessons for GB?

None that we are currently aware of.

CHAPTER 5 - OUR PROPOSED PRINCIPLES FOR ASSESSING OPTIONS

Question 6: Do you agree that our proposed principles for assessing options for residual charges are the right ones? Please suggest any specific changes, or new principles that you think should apply.

We agree with the principles set out, reducing distortions, fairness and proportionality and practical considerations, for assessing options for residual charges.

In addition, the principle of cost reflectivity is also important and should be applied to reduce the level of residual charges by correctly allocating costs.

CHAPTER 6 - SOME OPTIONS FOR SETTING RESIDUAL NETWORK CHARGES

Question 7: In future, which of these parties should pay the transmission residual charges: generators (transmission- or distribution-connected), storage (transmission- or distribution-connected), and demand, and why? What proportion of these charges should be recovered from each type of user?

All transmission customers should pay the appropriate level of transmission charges. It is important that costs are recovered from those who drive them on the network. Residual charges should be allocated according to the principles of non-distortion, fairness and practicability.

We consider it will be important in parallel with the TCR to review the level of residual charges to ensure the high level (80%) is correct.

Question 8: In future, which of these parties should pay the distribution residual charges: generators (transmission- or distribution-connected.), storage (transmission- or distribution-connected), and demand, and why? What proportion of these charges should be recovered from each type of user?

All distribution customers should pay the appropriate level of distribution charges. It is important that costs are recovered from those who drive them on the network however this must be balanced so that those who are unable to react to industry developments are not disproportionately penalised.

Whilst the residual charges are lower at Distribution than Transmission they remain high and further work should be undertaken in parallel with the TCR to identify and allocate costs to support the cost reflective approach. Distribution charging methodologies are complex and not always transparent, customers need to understand the basis of their charges and this is currently incomplete.

How customers use the network is also key to determining how customers should pay residual charges. A generator may have a very small demand which will limit the amount of residual costs they pay when in fact their generation also drives costs on the networks. In these cases it would be appropriate for generators to also pay an element of residual charges.

The same principle should apply to storage.

Question 9: Do you support any of the five options we have set out for residual charges below, and why?

Identifying the actual level of residual costs will help to drive the appropriate recovery mechanism.

Taking the options in turn:

- Option A: Has the potential for some customer groups to pay more, however the materiality cannot be understood until the level of residual charge is known.
- Option B: Again, the appropriateness of this will depend on the level of the residual fixed charge. If not set at an appropriate level price signals may be swamped and not assist in driving customer behaviour.
- Option C: This may be more appropriate for larger customers. For small, say domestic customers, the fixed charge would likely be fixed based on a typical / deemed capacity, therefore these customers would be unable to influence this charge without accompanying measures.
- Option D: The difficulties with gathering the data would impact the feasibility of this option.
- Option E: The hybrid approach may be the most appropriate to ensure that some customer groups are not disadvantaged although this must be balanced so that costs are recovered fairly from all who drive costs on the network.

Question 10: Are there other options for residual charges that you think we should consider, and why?

We believe that further work should be undertaken in parallel with the TCR to identify and allocate forward-looking costs so that the actual residual element is more accurately known. It is fair that this cost is recovered from all customers.

Question 11: Are there any options that you think we should rule out now? Please say why.

For the difficulties stated in the consultation it is unclear how using gross data could be progressed.

CHAPTER 7 - BENEFITS FOR SMALLER EMBEDDED GENERATION, RELATIVE TO OTHER GENERATION

Question 12: Do you think we should do further work to analyse the potential effects of the charging arrangements for smaller EG (called 'embedded benefits')?

We consider that the application of embedded benefits has resulted in significant distortions in the charges applied to transmission and distribution connected generation (<100MW). Furthermore, we have first-hand experience of how these distortions have influenced developers' decisions to connect at distribution rather than transmission voltages. Whilst we consider the work undertaken on CMP264/265 has the potential to address some of these distortions, it is evident further work is required to analyse the impact of the other embedded benefits components.

Question 13: Do you think changes are needed to the current charging arrangements for smaller EG, and when should any such changes be implemented?

Further analysis is required to fully understand the costs and benefits now imposed by EG on the network and, where found to be necessary, appropriate amendments made to the charging methodologies to establish a truly level playing field for all parties.

Question 14: Of the embedded benefits listed in our table, do you think that any should be a higher or lower priority?

We believe that the embedded benefits should be assessed as part of charging reviews to run in parallel with the TCR to understand who drives costs on the networks. This will inform the debate on how such costs should be recovered. We anticipate this will be part of a whole network charging review of which the TCR will form a part.

Question 15: Do you think there are other aspects of transmission or distribution network charging which put smaller EG, or any other forms of generation or demand, at a material disadvantage?

We cannot determine who would be at a material disadvantage until a comprehensive review of network charging is completed.

CHAPTER 8 - OUR VIEWS ON RESIDUAL AND BSUOS CHARGING FOR STORAGE

Question 16: Do you agree with our view that storage should not pay the current demand residual charge, at either transmission or distribution level?

The principles of applying costs (as mentioned in Question 6) should also apply to storage.

We consider that further work is required to more fully understand the costs and benefits imposed by storage on the network coupled with a comprehensive review of residual charges in order to more fully understand the appropriate methodology to be applied going forward.

Question 17: Do you agree with our view that storage should not pay BSUoS on both demand and generation?

This should form part of the wider review to fully assess the appropriateness for this charge on storage, and other, connections.

Question 18: Which of the BSUoS approaches describe is more likely to achieve a level playing field for storage?

This question should form part of the wider review to better understand what BSUoS charges Storage should attract.

Question 19: Do you think the changes in this chapter should be made ahead of any wider changes to residual charging that may happen in future? Do you agree with our view that these changes should be implemented by industry through the standard code change process?

We recognise that in certain scenarios storage will pay more residual charges than other users and support the view that changes are required to ensure that storage is not at an undue disadvantage relative to other users providing the same or similar services. We agree that changes are required earlier, as an interim measure, to address this. However, it is our view that storage should also be included in the wider review.

CHAPTER 9 - OUR APPROACH TO TAKING THESE CHANGES FORWARD

Question 20: We would welcome your thoughts on the potential make-up of a CCG. Please refer to the potential role, structure, prioritisation criteria and assessment criteria.

We are supportive of the establishment of the CCG to oversee the range of charging review activity taking place across the industry. It is important that this work is co-ordinated to ensure that the various charging development/review activity is carried out in a coherent manner, minimising the potential for conflict, duplication of effort and inefficiency generally.

We agree that Ofgem should chair this group with membership from:

- DNOs
- SO and TOs
- Customer representatives including: generators, storage and demand (industrial and domestic)
- Code Administrators
- Suppliers

Communication links between the CCG and the Targeted Charging Review, ENA TSO-DSO Charging Group, EDCM/CDCM Reviews and National Grid Charging review will be crucial as will communications between the various groups in order to facilitate best shared learning opportunities. The 'steering' role of the CCG will be critical in delivering this through the establishment of a clear direction of travel and common goals and principles.

Question 21: Do you agree with our proposed delivery model, including its scope?

We are agreed with the proposed delivery model. However, as noted above, additional work needs to be done in parallel with the TCR SCR, including a more comprehensive review of the level of residual charges and how costs are allocated.

Question 22: Do you agree that our proposed SCR process is most appropriate for taking forward the residual charging and other arrangements for smaller EG discussed in this document?

We agree that the proposed SCR process is appropriate for taking forward a coordinated review of residual charging arrangements.