

Andrew Self
Targeted Charging Review, Energy Systems Transition
Ofgem
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London
E14 4PU

4 February 2019

Dear Andrew

Targeted Charging Review: minded to decision and draft impact assessment

Thank you for the opportunity to respond to the above consultation. This response is on behalf of UK Power Networks' three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc. We are the UK's largest electricity Distribution Network Operator (DNO), dedicated to delivering a safe, secure and sustainable electricity supply to 8.3 million homes and businesses.

The energy system is undergoing fundamental change which is only set to accelerate with the combination of decentralisation of electricity generation and the electrification of the nation's transport and heat requirements. The electricity networks are at the heart of this transition and have a responsibility to enable it in the most efficient way possible. Key to the efficient delivery of the country's carbon targets will be a responsive electricity network which promotes flexibility while continuing to deliver a reliable power supply to customers.

We believe that a major part of achieving this future network could be cost-reflective charges. The charges that customers pay for the use of electricity networks provide the signal of their impact on the system and the value they can unlock through offering flexibility. Therefore, these charges and the signals they send could be the foundation of many of the flexible solutions currently used to efficiently manage network constraints and will also provide a neutral platform for development of future innovative solutions.

We recognise the work of the Targeted Charging Review to deliver reform of a major element of network charges. The residual charge is intended to reflect the non-variable cost of continuing to provide access to the network through customers' connections. The non-variable nature of these costs means that all customers connected to the network should contribute to these costs in a fair and equitable way which is not directly linked to their variable day-to-day consumption of energy.

Therefore, we understand why you have put forward your preferred option of setting the residual charge as a fixed cost. To ensure that this charge is cost-reflective and sends the right signals to customers, it is vital that this element is calibrated to reflect the non-variable costs of running the network that delivers electricity to customers' homes and businesses.

Your preferred option proposes a pragmatic mechanism to attribute these costs to customers within well-known existing customer categories. We note that, although each customer category will face a similar proportion of residual charges as seen historically, the apportionment of charges within these categories will change materially. While this could represent a suitable, cost-reflective way to distribute non-variable charges, we note that it may result in higher energy bills for those that use the least energy. Therefore, it is important that Ofgem is clear how vulnerable customers will be protected if they see increases to their energy bills through this change.

For the reasons noted above, it is important that the size of the overall residual charge is a true reflection of the non-variable costs of running the network. We will continue to work with Ofgem, network companies and wider stakeholders to develop a way to implement the outcomes of this review which achieves this. We also note the role that the Access Reform project will play in ensuring that network charges are accurately apportioned between forward-looking and residual charges. We look forward to playing a key role in the Access Reform work to ensure all strands of work relating to network charges work together as a whole. This will ensure network charges are fit for purpose and encourage efficient use of the network.

Regarding embedded benefits, these were introduced at a time when network conditions were very different to those we currently see and expect to materialise in the future. With conditions on the network being less static than in the past, we believe the work being carried out under the Access Reform project is better placed to value the benefits users are realising for the system. This will reflect the dynamic and varied nature of network constraints and where they are mitigated by the actions of users. The arrangements developed in the Access Reform project should be designed to value the support users provide to the network where this is the case and will obviate the need for static embedded benefits.

As mentioned above we look forward to continuing to support both the implementation of the outcomes of this review and the development of arrangements under the Access Reform project. We have provided specific answers to your consultation questions in the appendix. If you have any questions on this response, please do not hesitate to get in touch.

Yours sincerely

A handwritten signature in dark ink, appearing to read 'James Hope', with a stylized flourish at the end.

James Hope
Head of Regulation
UK Power Networks

Copy Paul Measday, Regulatory Returns & Compliance Manager, UK Power Networks
Erroll Marjoram, Head of Income Management, UK Power Networks
Ross Thompson, Regulatory Performance Manager, UK Power Networks

Appendix – Answers to specific consultation questions

1. Do you agree that residual charges should be levied on final demand only?

We agree that residual charges should only be levied on final demand as this reflects the principle that the system exists to supply electricity to end consumers. However, it is important to reflect that the actions of generators (and storage) facilities can also drive increased costs on the system. We believe the work of the Access Reform project will ensure that the impact of these users' behaviour will be reflected in their use of system charges.

2. Do you agree with how we have assessed the impacts of the changes we have considered against the principles? If you disagree with our assessment, please provide evidence for your reasoning.

We agree with how you have assessed the impacts of changes against the principles.

3. For each user, residual charges are currently based on the costs of the voltage level of the network to which a user is connected and the higher voltage levels of the network, but not from lower voltage levels below the user's connection. At this stage, we are not proposing changes to this aspect of the current arrangements. Are there other approaches that would better meet our TCR principles reducing harmful distortions, fairness and proportionality and practical considerations?

This approach produces cost-reflective charges specific to the extent of network required to service the user groups. Therefore, we agree that this is an appropriate approach to the calculation of residual charges.

4. As explained in paragraphs 4.41, 4.43, 4.46, 4.49, 4.80, we think we should prioritise equality within charging segments and equity across all segments. Do you agree that it is fair for all users in the same segment to pay the same charge, and the manner in which we have set the segments? If not, do you know of another approach with available data which would address this issue? Please provide evidence to support your answer.

We understand the reasoning behind charging all users within a segment the same residual charge and believe this will produce more cost reflective residual charges. We do however suggest that thought be given to including domestic two-rate customers within a single domestic customer segment. This will avoid these customers facing a higher residual charge which may not be justified given the similarity in how they impact non-variable costs.

Other approaches would require judgements to be made and further segmentation of customers than is possible with current systems and processes. There may also be a question of what factors are used to further disaggregate customer segments as any thresholds may be seen as arbitrary or subjective. This perception may be amplified if users in the more disaggregated customer segments face materially different charges.

5. Do you agree that similar customers with and without on-site generation should pay the same residual charges? Should both types of users face the same residual charge for their Line Loss Factor Class (LLFC)?

We agree that these users should face the same residual charge because, generally speaking, there is a similar non-variable cost involved in providing and maintaining these connections to the wider network. Where users have technology in place that, through a lower peak import/export, reduces their impact on the variable costs of operating the network, this should be reflected in the Forward Looking Charge. We trust that the Access Reform SCR will deliver arrangements that reflect this and ensure that these users are charged in a way that recognises their reduced impact.

6. Do you know of any reasons why the expected consumer benefits from our leading options might not materialise?

How energy retailers reflect these new arrangements remains to be seen. How these charges are reflected in customers' bills could potentially have an impact on their behaviour and therefore the benefits that may result.

7. Do you agree that our leading options will be more practical to implement than other options?

We agree that the leading options are more practical to implement than other potential options and also lead to more predictable charges for consumers. Of the two leading options, the preferred option can be delivered using information, categorisations and dataflows that are currently in place which leads to a solution that is more practical to implement.

8. Do you agree with the approaches set out for banding (either LLFC or demanding for agreed capacity)? If not please provide evidence as why different approaches to banding would better facilitate the TCR principles.

Answered with question 9 below.

9. Do you agree that LLFCs are a sensible way to segment residual charges? If not, are there other existing classifications that should be considered in more detail?

We agree that LLFCs are an appropriate and practical way to segment customers for the purposes of setting residual charges. These segments are well established and understood and allow these arrangements to be implemented using current dataflows between parties.

10. Do you agree with the conclusions we have drawn from our assessment of the following? a) distributional modelling b) the distributional impacts of the options c) our wider system modelling d) how we have interpreted the wider system modelling? Please be specific which assessment you agree/disagree with.

We agree with the conclusions of the distributional modelling given the current level of understanding of system arrangements. As noted elsewhere, we are aware of the multiple interactions with other ongoing work such as the Access Reform SCR and the development of DSO capabilities which will also have impacts in this area.

11. Do you agree with our proposed approach to the reform of the remaining non-locational Embedded Benefits?

We answer questions 11, 12 and 13 jointly below.

12. Do you agree with our proposal not to address any other remaining Embedded Benefits at this stage? Which of the embedded benefits do you think should be removed as outlined in xx? Please state your reasoning and provide evidence to support your answer.

We answer questions 11, 12 and 13 jointly below.

13. Are there any reasons we have not included that mean that the remaining Embedded Benefits should be maintained? (This answer applies to questions 11, 12 and 13)

We believe that static Embedded Benefits are not reflective of the dynamic nature of electricity network conditions. The work being carried out under the Access Reform SCR should seek to value the benefits that users may provide to the network and implement arrangements that reflect these benefits in users' charges. This may have an impact on the timing of removal of these Embedded Benefits.

14. Do you agree with our proposed approach to transitional arrangements for reforms to: a) transmission and distribution residual charges b) non-locational Embedded Benefits? Please provide evidence to indicate why different arrangements would be more appropriate.

We recognise that there is interaction between both of these areas with the recently launched Access Reform SCR. Therefore we can see merit in a phased approach to implementation that will allow these interactions to be factored in. However, the proposed approach is achievable in practical terms.

15. Do you agree with our minded to decision set out? If not please state your reasoning and provide evidence to support your answer.

With reference to the responses to the other individual questions, we broadly agree with the minded to decision.

16. For our preferred option do you think there are practical consideration or difficulties that we have not taken account of? Please provide evidence to support your answer.

We note the ongoing workshops to develop implementation proposals, however we do not see any practical difficulties with implementing the proposed arrangements from a DUoS charging perspective.