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Dear Andy,

Future Charging and Access programme – consultation on refined residual charging banding in the Targeted Charging Review

Thank you for giving us the opportunity to provide our views on the position set out in your recent letter on the Future Charging and Access programme – consultation on refined residual charging banding in the Targeted Charging Review.

Our prime concerns in considering these proposals are the impact on our customers, and on the wider industry. It is our experience that customers want predictable and transparent Distribution Use of System (DUoS) charges that they can readily understand. On the other hand, the wider industry wishes to see straightforward and stable pricing structures.

Fixed charges

Against these criteria the proposed solution you have set out has some key positive points. We are confident that the concept of a residual charge levied on a fixed basis is a considerable improvement on current arrangements.

Charging based on either a fixed or capacity basis provides more certain recovery of residual charges leading to more stable prices for customers overall. It also ensures customers are treated more equitably as using low carbon technologies would not result in avoidance of the residual charge.

Final demand

Broadly, we also support the principle of residual charges applying on the basis of final demand. However, we feel there are practical issues with this approach. Network companies currently do not have any way of identifying what share of metered demand is final or intermediate. Nor do we feel that industry has arrived at robust definitions of these concepts at this time. The measurement of final demand is particularly problematic for mixed sites where there might be a range of final demand, generation and storage behind a single meter at the point of connection.

If approved, the DCUSA change proposals we have raised (DCP341 and DCP342) to exempt storage sites from residual charges would provide a possible mechanism for identifying sites which are only used for storage. The intermediate demand of these sites could then be excluded from the calculation of residual charges. However, these changes will not help identify the level of final demand for mixed sites. As such our changes are only a partial solution to the difficulties resulting from this aspect of the TCR proposals.

Non-domestic banding

However, we have the greatest concerns regarding the proposal for banding, especially for non-domestic customers. We felt the classification of customers by LLFC was arbitrary and are pleased that this approach is not being pursued. Unfortunately we still have significant concerns regarding the latest proposals for banding.

The residual charge does not reflect costs which can be influenced by customers and so we do not think it is appropriate to introduce a tariff structure for residual charges which encourages customers to change their behaviour. We are concerned that the proposed bandings introduce a distorting signal for customers to manage capacity or volume, especially if they are close to one of the proposed tariff boundaries. As an example, based on figure 3 of your letter, an LV non-domestic customer moving from 280,000kWh per annum to 280,001kWh would pay an extra £9,380 in residual charges for that single kWh unit of electricity. This would very likely be the most expensive unit of electricity they ever purchase.

We recognise you have proposed measures to mitigate against this kind of distortion, particularly the allocation of customers to bands on an historic basis that is only periodically updated. It is our view that such an approach might result in customers sitting in bands that do not reflect their current status. This would be more frequently in a world where customers are engaged in a smart flexible energy system as part of a dynamic economy. In extreme cases customers might disconnect and reconnect to 'reset' their residual charge. In any event the potential for distortion of customer behaviour and the market would remain over the long term.

One of the stated principals of the TCR is fairness. Under the proposed banding system customers with a level of capacity or annual consumption just above a band boundary will face a significantly larger residual charge than a customer with marginally lower requirements. Aside from the potential distortions this may introduce, it simply does not seem fair to treat two broadly similar customers so differently.

Also, it is our view that the proposed bandings are overly complex. The introduction of a new system of classification of DUoS customers would result in the number of LV-HV non-domestic tariffs increasing by a factor of five. It would also introduce a new system of classification which would require significant industry changes. It is our view that forward looking charges are the most important element of overall DUoS charges, because they are greater and reflect costs that can be influenced by customer behaviour, and it does not seem proportionate to introduce this level of complexity to the tariff structure to accommodate residual charges. We also note that the work underway in the Forward Looking Charges SCR (FLC SCR) could potentially create a large increase in the number of tariffs, which would be further compounded by the TCR approach.

Domestic customers

With regard to domestic customers we strongly feel that options relating to differential charges for Economy 7 customers are inappropriate. Historically there may have been some justification for such a categorisation. However, given the introduction of smart meters and half hourly charging for domestic customers we do not feel that this is a valid distinction to apply to the current circumstances. Half hourly settled customers can operate storage heating and benefit from lower overnight rates without the need for Economy 7 metering. As a general principal we believe the solutions under the TCR should not discriminate between HH and NHH settled customers because any discrimination between these groups could provide an incentive for customers to not engage in the transition to a smart, flexible energy system.

Alternative approach and solutions

We believe any banding approach should be applied to the physical characteristics of the connection only. Such physical characteristics include the voltage level and metering type (either current transformer or whole current). The benefit of such an approach is that such physical characteristics do not change through behaviour and remain consistent over time. They also map easily to current tariff types, and we anticipate this would remain the case following the implementation of the FLC SCR.

In terms of the approach to progressing the TCR for distribution, we believe there is good reason to ensure the implementation timeline is more closely coordinated with the FLC SCR and the start of RIIO-ED2. There is likely to be significant benefits in having greater knowledge of the approach to forward looking charges, and hence the scale of the residual and proposed tariff structure, in designing the methodology for allocation of the residual.

We are also of the view that more pragmatic approaches might be considered. While forward looking charges are designed to promote economically efficient utilisation of the electricity system, it is a fact that they are based on approximations and have large margins of error. Given this, we feel more simplistic approaches such as simple scaling of the forward looking fixed charges should be considered.

Please do not hesitate to contact me if you have any questions regarding our response.

Yours sincerely,