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Targeted Charging Review
Energy Systems Transition
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Dear Andrew

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

Thank you for the opportunity to respond to the above consultation.

We strongly believe this proposal is a significant step backwards from the original ‘minded to’ TCR decision that was published in November 2018. While we understand Ofgem’s reasons to suggest using a banding approach, we disagree that it meets the TCR Principles for Customer Segmentation.

Our response is split into 2 sections:

1. The reasons we do not believe this new banding proposal meets the TCR Principles
2. Our suggestion for a more suitable solution which would better meet the TCR principles.

1 The reasons we do not believe this approach meets the TCR Principles

TCR PRINCIPLE 1: Reducing Harmful Distortions:

“The current arrangements that recover residual network charges encourage user behaviour that leads to harmful distortions in the market. They create incentives for some network users to take actions that reduce their residual charges and can increase the overall network system costs. Residual charges are intended for revenue recovery and are not meant to incentivise specific actions by network users” .

Under this approach, Ofgem “propose to set and allocate users to bands on a historic basis and update them periodically in line with price controls. This should also reduce any incentives to change behaviour in response to residual charges” . The whole premise of TCR was to prevent customers

from taking action to avoid charges, thereby increasing charges for others. We are concerned that this banding approach actually encourages this to happen.

High Voltage and EHV Customers (Capacity Banding):

Customers towards the lower end of the capacity boundary would have a financial incentive to lower their capacity to fall into a cheaper banding which would then be charged for the next 5 years. E.g.

- Using the illustrative numbers provided, a high voltage customer with an Agreed Supply Capacity of 2,600 kVA would pay a residual fixed charge ($5 \times £200,831$) = £1,004,155 over the 5 year price control period.
- If they reduced their ASC to, say, 2,450 kVA during the period when banding is set, they would pay a lower band residual fixed charge of ($5 \times £80,643$) = £403,215 over the 5 year price control period.
- This would be a massive financial saving of £600,940 over the 5 year price control period – possible only because the customer is situated at the lower end of the banding.
- These costs would be borne by other customers who were nearer the middle or upper limits of their banding and therefore unable to change their capacity to the lower banding.
- Customers at the higher end of the banding may choose to keep their current ASC and pay excess capacity charges rather than increase their capacity.
- There is also the potential that the above customer could then reapply to have their capacity increased again to 2,600 kVA?

This approach also appears to be dismissing any merit in customers handing back unused (perhaps hoarded) capacity which will allow the network operator to re-allocate to new connections without requiring reinforcement.

All Voltage Levels (Both Capacity and Volumetric Bandings)

The proposal, as drafted, does not appear to adequately consider the day to day application of the model. It does not reflect genuine changes in site use (either due to change of customer at a site or a radical change in business operations) i.e. A customer may be using much more or less than the band they have been allocated to. This is particularly relevant to the SME market which has a large churn of businesses at a site over a 5 year period.

Any allocation process using historical data that is put in place will require an appeals process. This is particularly relevant for consumption banding where data errors regularly occur (although it will also apply to capacity banding also). It is highly likely that erroneously high banding allocations will be appealed; erroneously low banding allocations will not.

The approach for new connections (i.e. a new business which has no energy consumption history) would need to be defined. There is clearly an opportunity for such sites to declare that they are

in a lower charging band than they actually are and potentially benefit from reduced charges for up to 5 years.

A process would also need to be put in place to ensure that any customer which was off-grid at the time the banding was allocated to them is then provided with a band if they reconnect to the network.

TCR PRINCIPLE 2: Fairness:

For Domestic customers, it makes sense to have a single fixed charge, by region (no differentiation between unrestricted and E7). This is fair.

For Non-Domestic Customers, the banding approach does not work. Using the illustrative numbers provided in the consultation:

- Customers will require clear and rational explanation why charges for an equivalent sized site may differ to one connected at a different voltage level.
- Arbitrary banding thresholds: There are significant step-changes in costs depending on which side of the threshold a site sits:
 - An HV customer with an ASC of 1390kVA will be charged £37,334 per year (£26.85/kVA p.a.) whereas a similar HV customer with an ASC of just 20kVA more (at 1410kVA) will be charged £80,643 per year (£57.19/kVA p.a.). This additional £43,000 cannot be justified. (We also note the discrepancy that a similar EHV customer with an ASC of 1410kVA will be charged £59,564 per year (£42.24/kVA p.a.). How could the lower rate for EHV be explained to customers?
 - An EHV customer with an ASC of 11,500kVA will be charged £174,092 per year (£15.13/kVA p.a.) whereas a slightly larger EHV customer with an ASC of 12,500kVA will be charged £846,545 per year, £672,000 more! (£67.72/kVA p.a.). Again this cannot be justified.
 - As previously mentioned, HV and EHV customers at the lower end of each banding are likely to attempt to re-set their ASC to step-down in to a lower threshold.
 - An LV consumer of 20,100 kWh will pay £582 more than an LV consumer who uses 19,900 kWh.
- The banding ranges are too wide – and appear difficult to justify.
 - A modest site at HV with an ASC of 510kVA will pay the same £37,334 (£73.20/kVA p.a.) charge as a more energy intensive site at 1390kVA (£26.85/kVA p.a.)
 - An EHV site with an ASC of 2600kVA will pay the same £174,092 (£66.95/kVA p.a.) charge as a large energy intensive site at 12000kVA (£14.50/kVA p.a.) An LV customer of 20,000 kWh will pay the same £783 (3.91p/kWh) charge as a 100,000 kWh customer (0.078p/kWh).

- Confidence in the published illustrative numbers
 - We would be keen to understand further how the illustrative numbers in Figures 2 and 3 were derived. How much confidence is there in the level of the illustrative values? For example, there has been a massive change for similar customers since the minded to decision. In the minded to decision (Figure 2) HV was originally calculated to be £3,024 or £54,950. In the new illustrative banded numbers (Figure 3), the HV fixed charge is £10,830 or £200,831. Can the difference in approaches be justified in terms of why one is better than the other?
- Customer Concerns
 - Some of our larger Industrial and Commercial customer have shared their concerns that they fear genuine harm to British businesses, particularly given the seemingly arbitrary thresholds (as demonstrated in the point above). Multinational customers will ultimately need to consider viability of GB plant versus sites in other countries i.e. some GB sites may be in jeopardy as a result of these proposals. There is concern also that Ofgem are currently only releasing half of the picture. The impact of Access and Forward Looking Charges will not be known for a long time. This leaves customers unable to budget and plan for future charges as a result of these major reforms to Network Charges.

TCR PRINCIPLE 3: Practicality & Proportionality:

This proposal is very different to the 'minded to' decision that was published last November. The previous approach used the current DUoS charging structure, splitting the customers based on the already used and proven approach of LLFC. Implementation would have been relatively easy, with limited system changes both for the industry and for suppliers. Forecasting of the charges as a result of the changes was reasonably straightforward since the data was available at that level of aggregation.

This new proposal, as it stands, is considerably more complex than the original 'minded to' position that was published in November. It will result in major industry system and changes. It will require

- New data items (customer banding field is not currently available)
- New Industry process to manage these data items
- New data flows between market participants.
- All non-domestic customers to be 'tagged' at a point in time to their relevant charging band which will last for 5 years.
- We would expect major costly industry system changes (e.g. DC, DA, Elexon, settlement flows, DNO, NG and supplier) to accommodate this suggested change. This is ultimately an additional cost to consumers.

This is against Ofgem's own principles that the solution should use available data and that system changes should be proportionate.

Consumption banding will also cause a practicality issue in the small non-domestic (SME) market where many sales are done through brokers / TPIs. Suppliers would need to release multiple tariffs

to the market, each differing according to consumption banding. There is a high risk that new customers will be signed up on the lowest consumption band tariff since customers would inevitably choose the cheapest tariff.

As previously stated above, there would need to be a new management process implemented around the banding allocation e.g, appeal process, change of use and new connections process to safeguard against unfair charging. This would introduce unnecessary complexity, increased process and system changes – all of which would be un-proportional to the change required.

2 Our suggestion for a more suitable solution which would better meet the TCR principles.

We were fully supportive of the ‘minded to’ position of using the Line Loss Factor Code (LLFC) approach of allocating customers to tariffs. This is currently used, it works and requires no system change for the initial allocation. We see no reason for that to change as the underlying way of splitting customers into groups.

We fully recognised in our ‘minded to’ consultation response that there was a fundamental flaw in the fixed charge approach in that it did not differentiate between different sizes of customers within such a large banding. Small customers were paying the same as larger customers in the LLFC grouping – and that was clearly unfair given the large spread of customer sizes within each grouping. As we have stated above, we do not believe the ‘banding proposal’ suggested in this consultation resolves those issues. We would suggest a second TCR-related £/kVA rate for HH tariffs and a second TCR-related p/kWh for nhh tariffs is applied along with a fixed charge (which could not be avoided) would address these ‘proportional’ and ‘fairness’ concerns.

For clarity, we are suggesting

- Calculate a fixed charge per LLFC tariff group – as per Ofgem minded to decision.
- For the domestic customer tariffs, apply that fixed charge to collect the residual charge (combine unrestricted and E7)
- For non-domestic customer tariffs
 - Take x% of that fixed charge (tbc) and apply as a fixed residual charge – this cannot be avoided.
 - Calculate the remaining residual revenue that needs to be recovered (£y) for each LLFC tariff group.
 - For HH tariffs with an ASC charge, divide the revenue remainder (£y) by the total ASC within the LLFC group to calculate a £/kVA (TCR Residual Agreed Capacity) for larger customers. Each mpan is then charged on their actual ASC.
 - For tariffs without an ASC, divide the revenue remainder (£y) by the total estimated annual kWh within the LLFC group to calculate a TCR residual p/kWh for smaller customers. This consumption that is charged should not be historical. It is TNUoS and DUoS billing month consumption. We would suggest that covers 365x48 half hours to make it less easy for customers to move consumption from specific charging periods, thereby meeting the ‘reducing harmful distortion’ criteria.

- Smaller customers (either ASC or consumption charged) within a given segment will therefore pay a lower, but proportionate charge than larger customer within the segment.
- The optimum % split between fixed and Agreed Capacity / consumption recovery would need to be calculated.

This approach would mean that a set proportion of the residual charge is unavoidable (fixed residual charge) but the ASC or consumption residual charge also reflects the size of the customer. This makes it fairer. System and process changes would be significantly reduced compared to the banding approach proposed in this consultation.

We would be keen to see analysis on how these changes affect real customers. Unlike the LLFC approach where the volume splits per LLFC group per region were available through the DNO CDCM models, the volume split proposed here under the data banding is not available. It would be helpful if Ofgem could obtain this data and publish those volume splits per region so analysis could be undertaken by DNOs, NG SO and suppliers on the impact of these changes.

We would be keen to arrange a meeting with you and your colleagues to discuss the contents of our consultation response further.

Yours sincerely

Helen Inwood

Helen Inwood

(by email so unsigned)

Non-Commodity Charging Manager