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30<sup>th</sup> September 2019

Dear Andy

### **Consultation on refined residual charging banding in the Targeted Charging Review**

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, storage and energy supply to end users. We have around five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy continues to support the policy intent of the TCR. The reforms provide the right incentives for customers and generators to operate on a fairer playing field. We do not repeat our previous detailed comments and views on the wider Targeted Charging Review however focus here on the specific areas Ofgem has identified in this consultation.

We welcome the opportunity to respond to the refined residual charging banding for non-domestic customers consultation published on the 3<sup>rd</sup> September 2019 which provides Ofgem's updated thinking on residual charge recovery reform.

We believe that the refined options proposed move too far away from Ofgem's simplicity and fairness principles. This will make the recovery of residual costs more impractical for suppliers reducing overall consumer benefits, may also lead to customers taking distortive actions to lower the contribution towards residual charges, and are likely to take longer to implement.

We have outlined in our response the deficiencies we see in the refined proposals and some practical solutions that will deliver a more robust solution whilst adhering to Ofgem's principles.

### **Refined Residual charging banding for non-domestic customer**

Ofgem originally proposed recovering residual network charges for non-domestic customers by linking charges to standard industry data, i.e. Line Loss Factors, which is a practical and proportionate approach to cost recovery. We supported this approach.

We recognise Ofgem's concerns using Line Loss Factor segmentation because it could lead to similar types of non-domestic customers facing different residual contribution despite being similar in characteristics.

To attempt and make recovery fairer Ofgem has introduced banding ranges in which a non-domestic customer resides. A customer site is allocated to either a volumetric or capacity bandings based on which voltage level they are connected on.

There are several points we want to raise with this refined option.

#### Volumetric banding for smaller non-domestic customers

**Allocating a customer to a band based on a volume measure has significant practical issues. It incorrectly assumes that a supplier has the necessary information<sup>1</sup> to accurately assign a customer to the right band. This puts additional risk and burden on the contractual arrangements the supplier has in place with a customer.**

There is no existing process that stores a customer's volumetric data that is centrally available to all suppliers. The customer or an appointed intermediary would be required to provide this data to the supplier. Inaccurate information would lead to customers being charged against incorrect bandings until such time as this can be corrected, if indeed this could be identified.

This has a knock-on impact for both the Supplier to create additional processes to audit volume data to ensure customers are in the correct residual charge bands and the network companies who will receive the incorrect contributions. This has the potential to create confusion amongst customers who are likely to see price corrections to their contracts.

This is particularly troublesome for fixed term contracts. Making changes to fixed term contracts undermines the value of these contracts which customers actively choose to give them the assurance of budget certainty.

Ofgem suggest that a customer remain in the same residual charging band for the duration of a network price control (i.e. five years). This creates a risk of gaming.

Customers should not be able to change behaviour to reduce their contribution towards Residual charges. By creating a large incentive to temporarily lower consumption before the bands are fixed, that is exactly what is likely to happen.

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<sup>1</sup> For customer's that suppliers have an existing relationship with, i.e. are currently supplying, historic volumetric data will be available. For new prospects, change of tenancies, customer's with metering issues, etc. this information will not be known.

We also believe that fixing the band for a long length of time is likely to be unfair as there will be genuine reasons why a customer's volume has changed (change of tenancy, closure of site, change of site use, etc.) and it would be inappropriate to continue charging them in the wrong band for this extended period of time.

#### Capacity banding for larger non-domestic customers

**We are comfortable with the use of Agreed Capacity to determine the level of network residual contribution but see no need to band them. Banding, as with Volumetric banding for smaller non-domestic sites, would require additional non-standard processes to be created, is likely to lead to poorer customer experience, take longer to implement than other solutions and lead to customers taking distortive actions to move into lower charge bands.**

The wide bandings illustrated by Ofgem poses an incentive for customers to lower their Capacity Values to move into lower bands which they will then remain in for up to five years (length of a Price Control). To illustrate this, EDF Energy has analysed its portfolio and have found that 11% of sites could benefit by £26,500<sup>2</sup> each year by reducing their Agreed Capacity level by up to 5% moving them into a lower band.

Extrapolating this to all suppliers over a five-year period could mean several million pounds of charges would be deflected to other non-domestic customers.

To demonstrate this further EDF Energy analysed the number of instances a new supply connection's initial capacity level request was changed either by the customer or at the request of the distribution company. We found almost one in three new connections changed their Agreed Capacity agreement whilst in the new connection process (in most cases it increased). Assigning an incorrect capacity value would in those instances, depending on the range of the bands, have placed those customers in the incorrect bands.

Narrower bands would limit any perverse incentives to lower Capacity levels but the practicality of bands in-itself is inefficient. It will lead to needless processes being created when simply using the allocated capacity level seems wholly appropriate.

#### Alternative approaches to recover residual network charges for non-domestic customer

There is no one correct way of recovering residual network costs in a fair manner, but we are concerned that these revised proposals by Ofgem create significant amounts of complexity.

For smaller, non-domestic customers we believe a more practical and simplistic approach to recover residual charges instead of volumetric bands would be to use a hybrid solution.

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<sup>2</sup> illustrative charges in proposed refined non-domestic banding table in Ofgem's consultation

This in fact was one Ofgem's original short-listed solutions which we also supported at the time.

This hybrid solution would recover a proportion of the residual charge through a fixed rate linked to the LLF and the remaining residual charge to be collected via a net volumetric measure. The net volumetric portion of recovery aligns with the volumetric approach Ofgem is seeking but is far more simplistic and removes the impracticality of the banding option.

For large sites, we would suggest simply removing any banding by capacity level and set charges based on the level of capacity the customer has agreed with their distribution company. This removes the perverse incentive to game capacity levels between bands and recovers a fairer contribution from customers based on a relevant and appropriate measure.

Our preference for residual charge recovery remains one that is based on the customer's LLF due to its simplicity and practicality. The alternative solutions outlined above are only offered to provide workable and practical solutions that keep with Ofgem's attempt to increase fairness.

Whilst we do not support the refined options outlined by Ofgem we wanted to provide a practical solution that could make those proposals workable. If this proposal is taken forward, the data required to allocate a customer in a banding segmentation needs to be centralised and available freely to industry participants. The qualification of a customer into a specific banding needs to be robust with clear processes to avoid gaming.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Binoy Dharsi on 07790 893 373. I confirm that this letter may be published.

Yours sincerely,

A handwritten signature in black ink, appearing to read "B. Dharsi".

Binoy Dharsi

**Market Rules Advisor, Policy & Regulation**