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By email only

25 August 2021

Dear Patrick

**Subject: Consultation on minded to positions for Ofgem's access and forward looking charges significant code review**

Shell welcomes the opportunity to respond to Ofgem's consultation on its minded to positions for the Access and Forward-Looking Charges Significant Code Review (AFLCR).

We agree that there is a case for change and that it is necessary to reform existing network access and charging arrangements to ensure that they are fit for purpose to support the energy transition and minimise costs for GB consumers.

Viewed individually, we support the minded-to positions proposed by Ofgem. In our view the proposed reforms are the most obvious and least regrets changes that could be proposed.

**Ofgem should consider measures to minimise risk and cost**

We are however concerned that at this stage of the process there remains limited visibility and significant uncertainty over both the timing and nature of potential further reform of both distribution and transmission charging arrangements. In addition, we understand from the consultation that there is a strong link between network access and charging reform and Ofgem's full chain flexibility programme – but do not yet have any visibility regarding the scope and timing of that programme.

As set out in our response to the review launch consultation in 2018, we remain concerned that the potentially wide-ranging scope of the review(s), together with other ongoing and potential further changes to network charging arrangements, continues to create

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significant uncertainty over the level of network charges for the end customer, suppliers, and generators. Network charges represent one of the biggest costs that GB generators face and a quarter of the household's electricity bill.

With respect to the uncertainty created by the review itself, the process should not prevent the industry from continuing to invest in new technologies, make medium- or long-term commercial commitments and test new business models over the next five years to achieve the energy transition. As network costs are so significant, they often form a critical element of any new business model, commercial commitments or in business planning to develop and deploy new generation or demand side management technologies. Investors will therefore factor in the necessary risk premiums for network charge uncertainty.

Suppliers also face uncertainty: directly, as the process may impact the method to calculate charges recovered from demand, as well as the mechanism used to recover those charges; and, indirectly as it will become more challenging for suppliers to forecast the level of cost pass through associated with (for example) the capacity market as the likely auction clearing price will be more challenging to forecast. This will make it significantly more challenging for supplier to set fixed tariffs at a cost-efficient level. The challenge associated with accurately forecasting costs for fixed tariffs has subsequently been exacerbated with the introduction of the cap on default tariffs.

We encourage Ofgem to consider the following actions to help mitigate the negative impact of uncertainty associated with this process and reduce implementation costs for industry and consumers:

1. Provide a forward-looking plan and process to take forward each element of the review and related reforms, including the anticipated timing, and consideration and explanation of how the different elements of charging reform are related.

It would be helpful to understand better the planned scope and timing for:

- a. the holistic review of forward-looking DUOS charges;
  - b. the potential review of forward looking TNUOS charges; and
  - c. the full chain flexibility programme, and how this relates to and impacts network access and charging reform.
2. As part of that forward-looking plan develop a common evidence base that can be used by both industry and Ofgem to understand the case for change and the efficiency of alternative solutions. To date the evidence base that has been

established to support the TCR and AFLCR processes has been piecemeal and decision specific.

For example, while we welcome the detailed and thorough impact assessment published alongside these proposals, it has been developed on the assumption that the other elements of the network charging framework remain the same – and Ofgem has clearly signalled that they will not.

We would find it helpful if Ofgem could provide an up-to-date evidence base that quantified the main defects that it currently sees with transmission and distribution charging as this would enable industry to better anticipate and understand proposed changes.

3. Taking on board lessons learned from the Targeted Charging Review (TCR) process it is important that timings associated with the proposed reforms are realistic – as this will help to minimise the cost of implementation. Parties will make commercial decisions based on their understanding of any decision, and any subsequent and unanticipated delay in implementation will result in increased costs.

It has taken three years to reach this stage of the ACFLR, and it is not yet clear when Ofgem will be able to take a final decision, so we are concerned that an April 2023 implementation date may be unrealistic. For example, currently the Embedded Export Tariff (EET) is paid by the Supplier with funds received from Elexon. To implement a new charge, we expect that the industry will need a minimum of 18 months to set up the necessary processes.

To be clear we are not suggesting unnecessary delays in implementation – our primary concern is that Ofgem takes due care to ensure that any implementation deadlines that are set are also realistic.

4. Request the relevant TSOs and DNOs to provide early sight of projected charges, or a reasonable range, as soon as possible after Ofgem makes a final decision.

Where consumers are on contracts where charges are passed-through once known, the difference between quotes (based on current qualitative information) and the actual charges may hurt consumers trust in the industry to provide good quality service. Where charges cannot be passed-through, suppliers must make a commercial decision, which could end up with consumers overpaying or suppliers being financially penalised when the appropriate information was not available.

5. Where a solution may result in a significant re-distribution of costs among network users, Ofgem should allow sufficient time for the changes to be implemented so that parties are able to make necessary changes to their business models.

Ofgem's decision on CMP265<sup>1</sup> and the gradual phase out of embedded benefits for small distribution connection generators over 3 years provided a good balance between certainty and proportionality – given the significant commercial impacts. We appreciate that this exact approach may not be replicable for all proposed reforms but is in our view an example of good practice.

An alternative approach to gradual implementation would be to allow for some sharing of the costs and risks associated with the proposed changes between market participants and network companies. Ultimately all charges would be fully recoverable by the network companies, but allowing risk sharing for a period of time may also enable lower implementation costs for the industry as a whole.

We view grandfathering as likely to be the least efficient and most complex approach to dealing with the potentially significant re-distributional impact of charging reform.

6. Related to that we think that it is only fair that Ofgem does allow customers the opportunity to adjust their business models to respond to significant changes. As noted in our response to Ofgem's consultation on CMP 343 we believe that consumers should be provided the opportunity to adjust their business model to respond to the new charging regime.

Under the approach proposed for CMP 343 a consumer may be locked into significantly higher network charges, in the region of £1-2 million per year, for having had consumption levels higher than a specific threshold in only one preceding year.

Where consumers can adjust their behaviour, we do not consider it proportionate or fair that they are then locked into charges that are £1-2 million per year higher based on a level of consumption two years prior to the new charge taking effect.

Our preference would be to adopt a more proportionate fixed charge per unit of capacity, rather than the banding approach proposed under CMP 343. This would better support end users to manage their electricity consumption as best suits their own

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<sup>1</sup> <https://www.ofgem.gov.uk/publications/embedded-benefits-impact-assessment-and-decision-industry-proposals-cmp264-and-cmp265-change-electricity-transmission-charging-arrangements-embedded-generators>

business needs, fosters positive engagement with economic signals from regulated activity. In other words, it is more customer centric.

As detailed earlier in this response, we understand that Ofgem may want to delay implementation of a decision to extend TNUoS charging to SDG until it has completed a wider review of TNUoS charging. We consider that this same principle to delay should apply in relation to the proposals outlined in CMP 343. Our preference is that TNUoS charging is reviewed holistically and comprehensively to such an extent that it is fit for purpose for many years to come.

The measures set out above, to help manage and mitigate commercial risks and reduce implementation costs, should be considered for each of three reforms proposed in Ofgem's minded-to decisions.

Below we respond to each of the proposed reforms in turn.

### **Shallower Distribution Connection Boundary**

Shell supports moving to a shallow connection charge at distribution level as we do not consider that the current set up drives the lowest cost to GB consumers. Moving to a shallow connection charge enables DNOs to take a more holistic and forward-looking approach, rather than incremental and reactive approach to network planning and consider alternative solutions to network reinforcement, which may provide a more cost-effective solution in the longer term.

We also support implementing the proposed change by April 2023 and consider that, of the three reforms proposed, this change should be prioritised to ensure timely and cost-effective implementation. Two of the main barriers that we face to deploying rapid (50kW) and ultra-rapid charging (150kW) EV charging infrastructure are the cost and the time associated with the distribution grid connection.

The proposal to move to a shallow connection charge for demand should significantly reduce costs where deployment currently requires network reinforcement. In our experience projects that have faced potential costs associated with DNO network reinforcement have been uneconomic.

We are concerned that the move to more shallow connection charges will result in increased delays in the time taken to connect to the network – as reducing the obligation on parties to pay for the connection may equally reduce customers influence over the connection process and timing. We are concerned that some DNOs are already stretched to meet all connection

requests and in our experience the connection process takes around 18 months for a relatively straight forward project.

We therefore suggest that Ofgem and the DNOs also consider how best to address the risk that moving to shallow charges could significantly increase the time taken to connect to the network. Potential measures could include:

1. Start planning now for a potential significant increase in connection requests following implementation on the 1 April 2023. From discussion with DNOs we understand that this is likely to be exacerbated as connections are deferred to benefit from lower connection costs;
2. Ofgem should consider options to reinforce DNO performance indicators to ensure that the connection process is appropriately efficient and customer centric; and
3. DNOs explore potential options to smooth the anticipated significant increase.

We see significant benefit in DNOs continuing work to develop the processes used to allocate available capacity to ensure that they are more customer centric. In our experience these processes are often more tailored to the demands of the network operators, rather than the challenges faced by network users or customers and sensible investment timescales.

In addition, we believe that supporting policy measures will be needed to support a cost-effective move to shallow connection charges, and we do not have good visibility of whether it is feasible to expect that the regulatory framework and DNOs will be set up to deliver such change efficiently.

We believe that these arrangements would include:

1. **Clear unbundling rules** as moving to shallow connection charges may create an incentive for DNOs to leverage any mechanism needed to (for example) manage congestion to increase its profits. We would expect Ofgem to enforce unbundling rules that are as strict at distribution level as they are at transmission level.
2. **An appropriate level of transparency**, for all market participants to have information on current and future anticipated distribution network conditions as a signal to investment decisions.
3. **Some form of locational signal at distribution level** , to replace the signal that is currently provided by the shallow-ish connection charge. This locational signal may not necessarily take the form of a network charge.
4. **Further development of congestion management tools** at the distribution level to ensure that any local congestion can be appropriately and cost-effectively managed by the relevant system operator.

5. **A price control processes that** ensures that a network owner or network operators' decisions on whether to invest in network reinforcement or accept increased congestion management costs **results in the most cost-effective outcome for consumers.**
6. **Holistic and forward-looking distribution network planning** – we would expect DNOs to proactively adopt a more holistic and forward-looking approach to network planning, which also considered alternatives to network reinforcement.

We expect that some of the elements set out above, such as the potential for some form of location signal, will be addressed in the planned wider review of forward-looking DUoS charging. We understand that this will still take place ahead of any final AFLCR decision. The lack of a minded-to decision on forward-looking DUoS charges means that we are, at this stage, commenting on an incomplete proposal.

Most of the other improvements listed above, which are important to achieving the maximum benefits associated with the proposed reform, sit outside of the scope of the AFLCR. We would therefore welcome commitment from Ofgem and distribution network companies to work together with industry to ensure that equal weight and urgency is placed on delivering these complementary reforms by April 2023.

Finally, we are concerned that with implementation of the proposed reform there will be a significant increase in ongoing DUoS charges. We would welcome Ofgem giving consideration on how best to allocate such cost increases as part of its AFLCR decision to ensure that this does not result in undue costs for customers or suppliers.

### **Better defined access rights**

We agree with Ofgem's proposals to improve the definition and choice of access rights at distribution network level. Better defined access rights, applied in a consistent way at all voltage levels, should enable network users to have greater choice when connecting to the system.

We consider that larger network users should be provided the option to choose between clearly defined interruptible access, time profiled access and financially firm access facilitated by flexibility markets and or the Balancing Mechanism. To be clear, in supporting the adoption of financially firm access for larger users at distribution level we are not promoting the adoption of connect and manage.

As part of its AFLCR decision we consider that Ofgem should require DNOs to phase out and replace current Active Network Management flexible connections with the newly defined access rights. The continuation of active network management would mean that

the full benefits of the proposed reform will not be realised and that active network management will continue to hide the true costs associated with network congestion, dull signals for network reinforcement and stunt development of flexibility markets.

Finally we note that Ofgem's current proposal is quite high level and open, both with respect how the new access rights should be defined and how customers should benefit from taking advantage of those new access rights. We consider that this will be the area that will require the most effort following Ofgem's final decision – and would welcome Ofgem's views on how the process to address those open questions should be structured. We note that until a product has been defined in detail it is challenging to consider how best to remunerate choices.

To unlock the potential benefits associated with better definition of access rights, it is also important to significantly improve the information available to network users on the capacity available at different voltage levels, as well as the level of unutilized or underutilised capacity that already been allocated and could be given up.

Finally, we would welcome Ofgem's thoughts on whether the proposed reform of access rights represents its view of enduring arrangements that would best facilitate the energy transition, or are a first step towards a more sophisticated approach to defining access rights that would enable even greater flexibility for large users and potentially secondary trading.

### **Extending TNUOS charging to Small Distributed Generation**

In principle Shell supports the extension of TNUOS charging to small distribution connected generation (SDG) as we believe that the ability of some SDG to avoid forward looking transmission charges is likely to increase overall network costs for all market participants and consumers and result in sub-optimal investment decisions.

In relation to the implementation options proposed, our preference is for Ofgem to adopt an approach that provides market participants with greater certainty regarding the likely policy decision that it will take, including implementation timing, and reduces the likelihood of significant consecutive changes to GB charging methodologies.

Shell also supports a wider review of TNUoS forward looking charges, and we consider that it should focus on addressing the following defects with the current methodology:

- 1. Volatility** – we have seen that the current method to calculate locational charges results in actual and potential charges that are both volatile and hard to forecast.



We have previously flagged that forward looking forecasts of TNUoS charges for a transmission connected project can have a credible range of uncertainty as high as £40 million per year. This range is partly driven by uncertainty over the reforms that Ofgem may pursue, as well as the method to calculate the locational charge.

While we fully recognize the benefits of a locational signal in helping to minimize costs for GB consumers, the current level of volatility does not support efficient investment decisions.

2. **Co-location** – it would be useful to review co-location as the current model was not designed for mixed sites. Our concern is that the current charging regime does not adequately reward projects, such as mixed solar and wind or solar and wind collocated with storage that also reduce the need for network reinforcement. Including this in a wider review will allow a more holistic and in-depth solution than the initial proposed CMP316 solution and allow storage and demand to be appropriately incorporated.

Related to that, the review should also consider how to reward network users where they facilitate a wider reduction in network costs. For example, where a generator or storage reduces the need to reinforce the network, that asset should be able to capture part of that benefit, to ensure that the market is able to deliver an efficient level of investment.

3. **Uncertainty and Magnitude** – there is currently significant regulatory risk around the magnitude of forward looking TNUoS and forecasting it, with many stakeholders calling for it to change, as well as it being a recurring live issue, such as with the mod CMP315, which was raised in 2019, suspended and is now running again. We consider that it would be beneficial for Ofgem to look at the issue more holistically, and also consider whether the split between Forward Looking and Residual charges is appropriate.

We understand that Ofgem may want to delay implementation of a decision to extend TNUoS charging to SDG until it has completed a wider review of forward looking TNUoS charges. However, Ofgem has provided limited details of the charging defects that it may wish to address in a wider review of TNUoS charging, the timings that may be associated

with that review and implementation of any potential changes, or how the potential review relates to Ofgem's work on Full Chain Flexibility.

Please contact me if there is any element of our response that you would like to discuss.

Yours sincerely,

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