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Sent by email to: FutureChargingandAccess@ofgem.gov.uk

Dear Patrick,

Consultation to descope the wide-ranging review of Distribution Use of System (DUoS) charges from the current Electricity Network Access and Forward Looking Charges Significant Code Review (Access SCR) and take it forward under a dedicated SCR with a revised timescale

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group.

To facilitate the delivery of the levels of flexibility that will be required to deliver net zero at lowest cost to consumers, arrangements need to ensure flexibility providers can get access to distribution networks under fair terms and that use of system charges provide effective signals which reflect the impact a change in behaviour will have on the future costs of the network.

We have previously set out our views on DUoS charging reform in response to Ofgem's open letter on shortlisted policy options, and our position remains unchanged from that response. We believe a successful outcome for the review, when combined with the connection charging and access reforms now being progressed separately, will be a set of arrangements that balance strong but predictable forward-looking charge signals with access arrangements that allow connections fairly and enable well-functioning local and national flexibility markets.

The descope of the reform of DUoS charging from the Access SCR is disappointing. However, we acknowledge that it has become necessary to facilitate the implementation of reforms to access and connection charging arrangements by April 2023. Therefore, we support descope the review of DUoS charges from the Access SCR and taking it forward under a dedicated SCR.

Our key recommendations for the review of DUoS charges are as follows:

- Charging arrangements need to provide effective forward-looking cost reflective signals that appropriately value the flexibility that users can provide
 - Include all relevant costs into Ultra-long-run marginal costs

- Maintain volumetric tariff elements, with some capacity elements, to align with the approach to network planning
- Ensure predictability through appropriate zonal grouping/averaging

In Appendix One we provide answers to the consultation questions and in Appendix Two we provide more detail on the recommendations above. I hope you find these helpful.

Please contact George Moran in the first instance if you have any questions.

Yours sincerely,

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Appendix One: Consultation Questions

1. Do you agree with our proposal to descope DUoS from the Access SCR and take it forward under a dedicated SCR with revised timescales?

The descope of the reform of DUoS charging from the Access SCR is disappointing. However, we acknowledge that it has become necessary to facilitate the implementation of reforms to access and connection charging arrangements by April 2023. Therefore, we support descope the review of DUoS charges from the Access SCR and taking it forward under a dedicated SCR.

2. What are your views on timescales for implementation of DUoS reform? How does this interact with wider market developments and what do we need to take into account?

It would be preferable for the review to be completed as quickly as possible, and for significant changes to be subject to phased or delayed implementation (but not grandfathering) to mitigate impacts on investor confidence of unduly abrupt change. Reforms may require complex modelling and systems changes, and at this stage we agree that the earliest possible date for implementation should be 2025.

3. What areas of interactions of DUoS with wider developments in policy/industry do we need to consider in our review?

Ofgem have captured the main interactions in the consultation. The only additional area we would note is that should the default tariff cap, or an equivalent successor, endure beyond 2023, Ofgem will need to consider the practical implications of reform options in setting an appropriate allowance for use of system charges within any tariff cap.

4. Have we considered all the impacts of a phased approach to delivering the original scope Access SCR?

Yes. In particular, we agree that it is not essential to reform DUoS at the same time as implementing phase 1 (access and connection charging reform) and that there is immediate value that can be realised through timely implementation of phase 1 policy changes.

5. Do you have any views on our proposal to retain the scope and governance arrangements of the original Access SCR?

We support this proposal.

6. Do you have any other information relevant to the subject matter of this consultation that we should consider?

We set out our views on DUoS charging reform in Appendix 2. These are unchanged from our response to Ofgem's open letter on shortlisted policy options.

Appendix Two

Distribution Locational Charging Model

Charging arrangements need to provide effective forward-looking cost reflective signals that recognise the benefits that users who offer flexibility can provide.

Ultra-Long-Run Marginal Cost

At least in the short to medium term, we believe that Long-Run Marginal Cost (LRMC) models are appropriate for network use of system charging, with short run operational and/or highly localised constraints managed through market-based flexibility procurement.

Our recommendation for this review is for an ultra-long-run approach to be applied at all voltage levels. This is likely to produce more stable and predictable long-term signals and will be more effective at influencing decisions than standard long run incremental cost approaches. The unpredictable and volatile forward-looking signals provided by the current EDCM approaches (more akin to standard incremental approaches) have been found to be ineffective at influencing behaviour or reducing reinforcement costs – with the EDCM Review¹ in 2015 recommending they be removed. Therefore, an ultra-long run approach is more likely to deliver long term consumer benefits by making forward-looking charges more predictable.

Short Run Marginal Cost (SMRC) models, based on operational timescales, would be complex to implement and are likely to be unfeasible within the SCR timescales. In the longer term, with significantly improved network monitoring and data, the feasibility of such approaches may improve and the question of whether they would support more efficient outcomes could be reconsidered. However, in the short to medium term we consider that they are inappropriate as they are unlikely to be as effective at signalling local and real time conditions or achieving competitive price discovery as a properly functioning flexibility market. We agree with the previous proposal not to shortlist these options.

Costs to be signalled

The forward-looking signal should include all relevant costs – direct costs of reinforcement and replacement as well as closely correlated costs. Since replacements costs are not currently included at Distribution level, including them in the forward-looking signal will improve the cost reflectivity of charges and will also have the effect of reducing the aggregate amount being recovered via residual charges and therefore any distortive effects of those residual charges. The proposed move to a shallow connection charging boundary should also reduce the aggregate amount being recovered via residual charges since the forward-looking element of charges will no longer need to be discounted to reflect notional customer contributions. We estimate that removing discounts for notional customer contributions from the Common Distribution Charging Methodology (CDCM) would increase the amount recovered from fixed and capacity charges by c. 60% (or £650m/yr).

Who should signals be sent to?

¹ See following link:

<https://www.energynetworks.org/assets/files/electricity/regulation/DCMF/EDCMReviewGroupFinalReport%2031Dec2015.pdf>

Generation and demand should receive equal and opposite signals. If a user contributes to upstream costs they should be charged and if they offset upstream costs, they should receive a credit. However, the structure of charges and credits faced by a customer does not have to be, and probably should not be, the same. For example, where costs are levied on the basis of agreed capacity (whether for demand or generation), it may not be appropriate for the opposing credits to also be paid on the basis of agreed capacity as this would result in payments being made even if no beneficial action has been taken that would act to reduce long term costs. Instead, use of system credits should be paid based on actual output/consumption.

Distribution Locational Charging Granularity

Predictability

It is important that reform delivers predictable signals to provide a degree of certainty to encourage efficient investments in flexibility. Charging arrangements need to be sufficiently predictable to allow longer-term investments to be made, for example where to locate or whether to invest in flexible technologies. There is a trade-off between the degree of locational granularity and the complexity, volatility and effectiveness of the resulting charging regime. For instance, the unpredictable and volatile forward-looking signals provided by the current EDCM approaches have been found to be ineffective at influencing behaviour or reducing reinforcement costs – with the EDCM Review in 2015 recommending they be removed. At least into the medium term we consider flexibility markets will be more effective at responding to specific localised and/or real time conditions, whilst use of system charging methodologies should focus on deriving broadly accurate but predictable long-term signals.

Zonal Grouping

To achieve the desired degree of predictability in network charging, there will be a need for a degree of zonal averaging, which we envisage would encompass groupings of primary substations. Such zonal grouping should be viewed as an improvement in the effectiveness of the forward-looking signals rather than a reduction in cost reflectivity of otherwise ineffective and unpredictable signals (like the current EDCM charges).

Practicality

Arrangements need to be practical and proportionate, in particular for small users. Customers at lower voltages should be grouped into a small number of groups either by geography, electrical connectivity or by standard archetype models (e.g. generation/demand dominated) to improve the cost reflectivity of the network charges compared to today, whilst managing the complexity and practicality of the resulting regime. The prospect of hundreds or even thousands of sets of DUoS tariffs for small users is not practical and likely to be unfeasible in the SCR timescales.

Distribution Network Charge Design

Network Planning Alignment

To produce effective and cost-reflective signals, it is important that network charge design uses cost drivers which are broadly aligned with network planning assumptions. Alignment with network planning requires different approaches depending on the proximity of a user to a network level being charged for. Capacity based charges are appropriate for network levels

close to the point of connection, whilst volumetric time-of-use (ToU) charges are appropriate for more remote network levels.

- **Agreed Capacity/fixed charges for local network levels:** At network levels close to the point of connection, network investment will typically be driven by the capacity/access requests of local customers and therefore capacity is the appropriate charging structure for local network levels, although converted to a fixed charge for smaller customers for practicality. The charge design in the current CDCM follows this approach, and as set out earlier, it is worth noting that the proposed move to a shallow connection charging boundary at distribution would lead to a significant rebalancing towards capacity/fixed based charges as local network discounts for notional customer contributions would be removed.
- **Volumetric Time-of-Use for remote network levels:** Further away from the point of connection of a customer, it will be the diversified demand of that customer along with all other customers that will drive network investment (not the aggregate of capacity requests from these customers) and so it is more appropriate to apply a ToU volumetric charge for these remote network levels. Volume based charges with high charge periods that vary by time of day and season will be easy to understand and will broadly reflect network cost drivers.

Dynamic charging/ Critical Peak Rebates are inappropriate and unfeasible

Dynamic charges set shortly in advance, or rebates paid to those who reduce usage during peak times would be complex to implement and unfeasible within SCR timescales. We agree with the previous proposal not to shortlist these options.

Small Users:

Time of Use charges

We believe that ToU charges are a simpler approach to incentivising efficient use of the network compared to changes to access rights. All small users should face the same cost reflective charge signals.

Potential mitigations/adaptations

We consider that existing retail principles based regulation should be sufficient protection in the main. However there may also be merit in considering the role of wider policies for more targeted protection of vulnerable users.

Specific Forward Looking Charge (FLC) adaptation

We note that any specific FLC adaptations are likely to need to be applied to all for practicality reasons. If small users are not subject to cost reflective signals it will be important to understand any potential limitations this may place on the provision of flexible solutions in the future. Such a charging approach could exclude the majority of demand (c. 63%) that makes up peak demand from responding to cost reflective signals and the review would need to make sure that this would not result in everyone paying more for network charges, due to more traditional reinforcement, in order to avoid some (flexible) people paying less than others (non-flexible). As set out above, we consider a targeted retail based approach is worthy of consideration and is likely to be more effective at protecting vulnerable users.