

To: electricitynetworkcharging@ofgem.gov.uk

Date: 01 December 2023

Dear Ofgem,

Open Letter Response: IDNO Regulation Reform

Executive Summary

Eclipse Power Networks is pleased to respond to Ofgem's open letter on IDNO Regulation Reform. The industry, and the environment it operates within, has changed almost beyond recognition since privatisation. That pace of change continues to increase.

IDNOs were introduced to help solve a particular problem, but have proven themselves to be flexible, agile, and innovative in responding to the changes in the industry, particularly regarding the connection of onshore Net Zero solutions. This should be seen positively, rather than in the context of IDNOs extending beyond their original brief. Providing quality, value and rapid response to our customers is at our heart here in Eclipse.

We have explained how we feel that Ofgem's concerns are being handled by us. We have also responded to the two questions posed in the open letter, articulating where we see the benefits provided by our business. IDNOs are starting to fill a significant gap in the traditional network offerings, at the higher voltages.

Some of the issues mentioned in the open letter arise directly or indirectly from regulatory uncertainty, as well as from the lack of transparency in DNO boundary charges, and this too is discussed below. Uncertainty, as ever, is probably the biggest single factor affecting our business and the industry, so moves to reduce this are to be welcomed.

We agree that the regulatory environment needs to be reviewed regularly as the energy world evolves, particularly in the EHV and local transmission connections space. However, we strongly believe that any moves to limit further IDNO activity in these spaces would be counter-productive for the industry, its customers and society, and trust that this is not the intention that is being signalled by this open letter.

We ask that Ofgem keeps focussed on the fact that IDNOs earn their income via DUoS, without the benefit of receiving a return on a Regulated Asset Base like the DNOs. With this, they must cover all their business costs, including the provision of a subsidy on customer asset costs.

Eclipse is happy for this response to be placed in the public domain.

Background

The electricity industry has evolved significantly since privatisation and has undergone a series of increasingly rapid transformations in response to various external market, climate, and technological influences:

- When IDNOs were first created in 2004, the energy world did not include options such as **wind and solar generation** in significant quantities, and the idea of **storing electricity** was

not regarded as being economically possible. The concept of IDNOs, and the regulation adopted for them, reflected the need to meet the need for more “**last mile**”, predominantly domestic demand, distribution networks.

- Ten years later, and **offshore wind** was becoming a reality, requiring new regulatory vehicles and measures (e.g., for OFTOs).
- Within the next 5 years, **onshore wind**, solar power, and **battery storage** were starting to appear.

Whilst IDNOs weren’t originally envisaged to work with generation or storage projects, their agility and capacity to “get things done” started to be valued by these new customers as an alternative to the traditional TO/DNO connection route.

The energy world is becoming increasingly dynamic, requiring innovation, flexibility, agility and above all resources, to be able to keep pace with the changes needed. IDNOs have shown that they have a vital part to play in this mix, and well beyond the original role envisaged for them. Eclipse is especially proud to be able to demonstrate that we have strong support from our customers, particularly at or above the EHV level.

The concerns that Ofgem has expressed, particularly regarding EHV connections, are discussed below.

EHV Charging Methodology

From the open letter, Ofgem has apparent specific concerns regarding IDNOs operating EHV charging methodologies:

“Proposed EHV methodologies that do not have a reference point for calculating charges (or a host DNO in the case of a direct transmission connection) may be more akin to DNO price controls but without the same level of scrutiny or output regulation. This is because there is no relative cap on revenues.”

It was noted in the Charging Futures Forum, on 31st October, that there is a broader concern about the predictability of EHV charges (whether from DNOs or IDNOs). As noted in the open letter this problem largely arises because the EHV charging methodologies used by DNOs are opaque; additionally, the final charges from the DNO are often only visible at a very late stage, meaning that IDNOs often must work “at risk”. If DNOs were required to share more information, (such as Site-Specific Charges and Boundary Charges) more quickly and transparently, investment uncertainty for customers would be reduced, and IDNO scrutiny would be simpler. Eclipse operates a “cost reflective” charging policy at EHV (and for transmission connections), in the absence of more transparent mechanisms linked to the DNOs. The methodologies used by different IDNOs could also be part of the problem here.

However, full price control and regulation would place an uneconomic burden on IDNOs, which are typically small organisations without access to large regulatory staffing. IDNOs receive their revenue from DUoS alone and accordingly must remain lean and agile. Adopting annual audit tests for IDNOs could address this to some extent, without adding too much to their organisational costs.

Reaching a consensus regarding IDNO EHV charging methodologies could also be an additional efficient alternative to full regulation. Ideally this would sit along with a standardisation and simplification on how DNOs calculate the Site-Specific Charges, their timescales for doing so, and perhaps a re-balance away from large boundary charges for generation sites, to allow effective competition for generation connections.

Charging for Direct Transmission Connections

Charging for direct connections to transmission is more difficult, because as noted by Ofgem above, there are no host DNO reference points to work with. In the absence of anything more specific, and whilst aiming to be fair to our customers, at Eclipse we use a “cost reflective” charging model, as at EHV, again aiming to ensure that our customers are offered DNO-competitive rates.

We agree that this is an area that would benefit from clearer rules, and possibly further annual regulatory audit tests on similar lines to our suggestions for EHV charging.

Customer Risk

Ofgem also has risk-based concerns for customers connecting at EHV and directly at transmission level:

“Without a reference point for setting tariffs, we are also concerned that connecting customers may be exposed to undue risk where long term contracts are agreed under these arrangements.”

The nature of the risks being expressed needs to be better explained here. EHV customers tend to be larger, and more commercially aware than domestic customers, and better able to understand the nature of the contracts they are engaging in, as well as prevailing market prices. Is Ofgem saying that IDNOs are perceived as being a bigger risk than DNOs? Both are regulated, so is the concern regarding IDNO viability and / or the fact that there is currently no concept or IDNO of Last Resort? Is it concerning a tariff risk? There is no additional tariff cost, and in fact costs are generally lower for the customer when connecting via the IDNO rather than the DNO (and the IDNO gives other technical and commercial advantages to connectees). We do not consider the risk facing customers connecting to IDNOs to be greater than for customers connecting to a DNO where site specific charges apply. In either case, charges may be subject to increases over the long-term.

Connection Configurations

For those IDNOs seeking to connect directly to Transmission, Ofgem has concerns that:

“Some connection configurations may not be as shareable or economic and efficient as other options.”

The nature of the connection configurations being alluded to here needs further explanation by Ofgem. The provisions of the Electricity Act requiring distributors to make a connection between their network and a premises, or another network, apply equally to all distributors and we see no particular reason why connections made by an IDNO should be any less shareable or less economic. This is reinforced by virtue of the application of SLC 31E which requires all distributors to consider proposals which are beneficial for the whole system. There are always relative differences in designs, so is Ofgem suggesting that the standards are not fit for purpose, or are somehow being interpreted differently by IDNOs?

At Eclipse, we place great store on our value engineering. As asset managers, building inefficient or uneconomic plant configurations is not in our interests. Most of our configurations will be for normal arrangements, where there are clear standards and guidelines to follow; we have sought derogations against them if necessary for generation/BESS customers. Certain generation connection arrangements may require more creative configurations, but these will also need to be economic and efficient to operate too. Typically, these will be built with spare capacity for future expansion if required.

System Costs and Fair Recovery

For those IDNOs seeking to connect directly to Transmission, Ofgem has concerns that:

“Fair recovery of shared network costs among all customers may not be possible” and that this arrangement may have been part of the reason for customers to seek a connection to the transmission network directly from an IDNO. We take this reference to mean that a distribution customer connected directly to the transmission network by an IDNO may avoid paying the residual element of the tariff which they would have otherwise been liable for if they had connected to the DNO network. We understand that this may create perverse incentives in determining the solution for connections for extremely large demand sites and that in developing these solutions is important to consider the impact on the total system. However, it is also important to understand this issue in the wider context of distribution charging. If a customer is connected via a private wire to a co-located generator, then they too are likely to avoid costs associated with the incumbent DNO’s residual tariff.

We do not suggest that it is in the interest of the wider electricity customer base for customers to seek to avoid the distribution residual charge where it is Ofgem’s policy that it should be shared but we think that sensible solutions can be brought which can allow for the sharing of network costs between appropriate customers. We note that the incentive would not be as real if the quantum of the residual charge was reduced by more accurate allocation of costs to the forward-looking component of the tariff. One of the intended outcomes of Ofgem’s Targeted Charging Review was to remove incentives associated with the residual charge for distribution. We believe that this is a positive outcome for consumers and one which we fully support but we believe that this needs to be resolved through the proper allocation of costs to incentivise behaviours for connection and ongoing use of system.

A further area of concern indicated is that *“Significant differences between DNO and IDNO solutions may give rise to higher overall whole system costs.”* We feel that this may be an unjustified concern, as IDNOs only charge DUoS for their works, undertaken contestably against the DNOs, without the further costs of RAB which DNOs bring. Have we understood your concern correctly? More explanation here would have been helpful, as this phrase is a little vague. If it refers to a combination of the concerns noted regarding the fair recovery of shared network costs, and those concerning connection configurations, we have commented upon them above.

Responses to Ofgem’s Questions

These responses have already largely been included above and are shown here again as a summary.

1. What do you consider to be the pros/cons of IDNOs connecting EHV customers embedded within distribution networks?

- Connection at EHV supports larger installations more efficiently.
- Simpler connection process - IDNO’s are not monopoly businesses and tend to be more customer focused and are therefore easier to use than the DNO when clients are designing, building, and bringing the connection in to operation, which often helps the project get energised more quickly and therefore delivers customer revenues more quickly.
- Option of using multiple metering points. These occur where some clients prefer to split their site demand/generation up into smaller metered connections and will typically use an IDNO’s flexibility to extend the licensed network down to individually metered connections. This means that the customer avoids owning shared use assets, is not paying for cable losses and can utilise the IDNO’s Statutory Undertaker’s status to put cables in the public highway. By doing this, these assets can of course be used by others too. It also

means the customer has off-loaded the responsibility for the off-site network assets in the public highway to a licensed network operator with the appropriate competencies for managing opening notices and asset faults. DNOs may offer to take on assets in this way too but may charge significant additional maintenance fees when doing so.

- IDNO customers can receive capital contributions funded from the IDNO's future regulated revenues to subsidise the grid connection costs.
- Competitive value engineering - the IDNO might be able to assist in 'value engineering' the IDNO adopted contestable works and save grid connection costs or take better advantage of space at the Point of Supply by using a more appropriate design acceptable to the IDNO that facilitates a more acceptable design.
- IDNOs live by DUoS alone, so must remain lean and agile. DNOs have RAB, DUoS and other recoveries available. This is a significant benefit to consumers / customers, lowering costs overall.

2. What do you consider to be the pros/cons of IDNOs connecting directly to the transmission network?

The biggest driver is customer choice, which IDNOs can help facilitate:

- The flexibility to provide local generation and storage for communities efficiently, without being constrained by the location of transmission GSPs.
- Developers that previously focused on distribution connections are now seeking connections at 400kV, to connect to the NETS.
- IDNOs that can connect to the NETS can offer some mitigation to the risks that might otherwise be experienced by such companies.
- These companies are generally project financed, with specialisms in Battery, PV, and Onshore Wind, and will have little experience in the construction, operation, and maintenance of high voltage (400kV) assets. Gaining this capability, even by contracting out, may be done at a considerable premium. IDNOs can specialise in the operation and management of these assets.
- The minimum project size required to make the procurement and utilisation of a 400kV transformer financially viable can be a barrier to market entry and limit the market to companies with the deepest pockets rather than the most innovative solutions, whereas an IDNO is in a better position to leverage better value.
- Further project cost risk is reduced as developers can better fund their connection assets because of the AV contributions made by the IDNO.
- IDNOs are more responsive to the needs of their customer base as they are solely focused on Distribution and Transmission and are not competing for company focus and resource with other projects such as the delivery of large wider strategic reinforcement or seabed HVDC connections.

- As this model is inherently competitive, IDNOs are likely to be more innovative in their approach.
- Extending licensed networks to multi-customer sites, reduces the number of private networks, and thereby concentrates asset, operational and safety management in specialist hands. In England and Wales, NGET will not extend networks, and IDNOs will.
- Simpler connection process, with fewer delays than connecting via TOs at transmission level.
- Lower connection cost for customer compared to connecting via a TO.
- Lower network charges for customer, with only DUoS currently being payable.
- Risk mitigation – Embedded Distribution connection direct from NGET is inherently reliable, dedicated, often easier and may be quicker to deliver, where the NGET substation is closer to the Point of Supply than the nearest DNO primary.
- Metering location - Embedded Distribution connection direct from NGET means moving the licensed boundary metering point to the Point of Supply (where they would prefer to be metered, i.e. closer to the demand/generation). Means customer is not paying for cable losses and can utilise the IDNO's Statutory Undertaker's status to put cables in the public highway. Also means the customer has off-loaded the responsibility for the off-site network assets in the public highway to a licensed network operator with the appropriate competencies for managing opening notices and asset faults.
- IDNO customers can receive capital contributions funded from the IDNO's future regulated revenues to subsidise the grid connection costs.
- Competitive value engineering - the IDNO might be able to assist in 'value engineering' the IDNO adopted contestable works and save grid connection costs or take better advantage of space at the Point of Supply by using a more appropriate design acceptable to the IDNO that facilitates a more acceptable design.
- IDNOs live by DUoS alone, so must remain lean and agile. DNOs and TOs have RAB, DUoS, TNUoS and other recoveries available. This is a significant benefit to consumers / customers, lowering costs overall.

Conclusions

In making this response to the open letter, we have gone further than was asked, by attempting to consider the key concerns that Ofgem appears to have with IDNO regulation. We have also picked out the most important benefits for making IDNO connections at EHV and at transmission level. As noted at various points above, when compared with DNOs,



T 01234 486487
E enquiries@eclipsepower.co.uk

Olney Office Park
25 Osier Way
Olney
Buckinghamshire
MK46 5FP

eclipsepower.co.uk

IDNOs rely on DUoS for their revenue, with no RAB safety net. The fact that they can still run viable businesses is down to their agility, innovation, and efficiency. We trust that Ofgem keeps this thought front and centre as it considers how to move forward with IDNO regulation.

Kind regards,

Sarah Owen

Director of Finance, Regulation & Performance

Eclipse Power

07719 104550

www.eclipsepower.co.uk

<https://www.linkedin.com/company/eclipse-power-networks/>