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Targeted Charging Review  
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4 February 2019

Dear Andrew,

### **Response to Targeted Charging Review Consultation**

Thank you for the opportunity to respond to your Targeted Charging Review: minded to decision and draft impact assessment.

Whilst we are broadly supportive of the approach in general, there are detailed implementation issues in terms of segmenting users that need to be considered. We also believe that the user group contribution to system peak approach is a better mechanism in electricity distribution for allocating the residual charge amount to different user groups as opposed to consumption. In terms of cost recovery, we agree with Ofgem that a fixed charge approach is appropriate for smaller users with an agreed capacity approach for larger users. A capacity approach for smaller users has implementation issues though it may be appropriate to revisit this approach following the access review and the rollout of smart meters. We also believe there are significant implementation issues for transmission that may be best addressed by billing the transmission residual charge through DUoS tariffs.

Our responses to the consultation questions are attached. We are ready to support Ofgem in developing pragmatic solutions to implementation to enable changes to residual charges to be implemented with minimal disruption and in the most cost effective manner.

Yours sincerely



**Tony McEntee**  
**Head of Commercial Innovation**

## **RESPONSES TO QUESTIONS**

### **Chapter 4**

**Question 1: Do you agree that residual charges should be levied on final demand only?**

We agree with the decision that residual charges should be levied on final demand only. Final demand will inevitably pay, in any case, and as stated in your analysis it removes potential harmful distortions. Some of the terminology in the paper could however be clearer. We are comfortable that 'intermediate' demand taken by storage facilities with the intention of re-exporting the energy onto the system should be excluded. However demand taken by storage facilities for later consumption as defined in footnote 19 on page 14 should be treated as final demand and subject to residual charges.

**Question 2: Do you agree with how we have assessed the impacts of the changes we have considered against the principles? If you disagree with our assessment, please provide evidence for your reasoning.**

We support the approach used to analyse the options which produced the Fixed Charge and Agreed Capacity Charge approaches as the leading options. We do not fully support the analysis between these two options which needs further development. We are comfortable with the analysis for smaller users, but we do not think it properly reflects the impacts on larger users, i.e. those users who already have a defined capacity. For those users the proportional and practical assessment would also be green as the process is broadly in line with current arrangements. With regard to fairness we believe that the Agreed Capacity approach should be green and the Fixed Charge approach should be amber for these large users. There can be huge differences in capacities for these large users, and it would not be fair for all customers to pay the same. These charges are contributing to the fixed/ sunk costs of the system which generally relate to the capacity that is required.

**Question 3: For each user, residual charges are currently based on the costs of the voltage level of the network to which a user is connected and the higher voltage levels of the network, but not from lower voltage levels below the user's connection. At this stage, we are not proposing changes to this aspect of the current arrangements. Are there other approaches that would better meet our TCR principles reducing harmful distortions, fairness and proportionality and practical considerations?**

We support the approach and we are not aware of other approaches that would better meet the TCR principles.

**Question 4: As explained in paragraphs 4.41, 4.43, 4.46, 4.49, 4.80, we think we should prioritise equality within charging segments and equity across all segments. Do you agree that it is fair for all users in the same segment to pay the same charge, and the manner in which we have set the segments? If not, do you know of another approach with available data which would address this issue? Please provide evidence to support your answer.**

We support the approach of equality within charging segments and equity across all segments, however we do not believe that the proposals as they currently stand achieve this. To ensure equity across segment we believe that the allocation approach should be on the estimated contribution to system peak demand and not energy consumption, as total consumption is not a recognised cost driver in electricity distribution but has been used to estimate peak demand using consumption profile coefficients. The supporting data is already available in the distribution charging models (Common Distribution Charging Methodology and EHV Distribution Charging Methodology). It is not necessary to have the same approach for allocation and for charging. For example, in the current charging models costs are allocated based on estimated demand and recovered through volumetric charges. We believe that the residual element for unmetered supplies should continue be recovered on a

kWh basis and not a fixed cost per inventory to avoid the incentive to consolidate inventories to avoid residual charges.

In our opinion, the overall approach should be as follows:

Allocation Approach		Charge Base	
Small Users	Allocate based on estimated contribution to system peak demand from DUoS models	Small Users	Fixed Charge
Unmetered Supplies		Unmetered Supplies	kWh Charge
Large Users		Large Users	Agreed Capacity Charge

The estimated impact of this approach on 2020/21 tariffs is as follows

Group	Current Average Annual Bill (£)	Revised Average Annual Bill (£)	Increase (£)	Percentage Increase
Domestic Unrestricted	85.87	88.90	3.03	3.5%
Domestic Two rate	104.15	96.49	-7.67	-7.4%
Small Non-Domestic	309.66	332.21	22.55	7.3%
Large LV	5,380.86	5,344.72	-36.15	-0.7%
Large HV	32,199.78	29,575.24	-2,624.54	-8.2%
Unmetered Supplies	13,121.29	13,003.40	-117.90	-0.9%
EHV	142,468	147,220	4,751.77	3.3%

Whilst we acknowledge that this approach may not give the expected benefits to domestic customers envisaged in the impact assessment, consideration must also be given to the potential impacts of other users may have on domestic customers indirectly through for example employment.

**Question 5: Do you agree that similar customers with and without on-site generation should pay the same residual charges? Should both types of users face the same residual charge for their Line Loss Factor Class (LLFC)?**

We agree that similar customers with and without on-site generation should pay the same residual charges.

**Question 6: Do you know of any reasons why the expected consumer benefits from our leading options might not materialise?**

We are not aware of any reasons why the expected customer benefits would not materialise.

**Question 7: Do you agree that our leading options will be more practical to implement than other options?**

Yes, the leading options are fairly easy to implement for distribution providing the changes are implemented with the normal tariff change timescales. If the transmission residual is levied on suppliers directly by the NGESO then this will require duplication of existing processes and result in unnecessary industry change and cost. Levying the transmission

residual is levied through the DUoS tariff may be a more pragmatic alternative that should be fully evaluated. This is explained further in our response to question 16.

**Question 8: Do you agree with the approaches set out for banding (either LLFC or demanding for agreed capacity)? If not please provide evidence as why different approaches to banding would better facilitate the TCR principles.**

No, we believe banding should be based on existing DUoS tariffs not LLFCs. These already group customers through well established processes based on voltage of connection and type of user. There is no justification for introducing new banding approaches to implement the TCR. See our response to question 9.

**Question 9: Do you agree that LLFCs are a sensible way to segment residual charges? If not, are there other existing classifications that should be considered in more detail?**

LLFCs are not a sensible way to segment residual charges.

We do not believe this is a good approach because the splits between LLFC groups are used for other purposes and would not be appropriate to allocate residual charges. For example, in our area we use different LLFCs for Domestic Unrestricted customers to help us identify if we own the customer's meter, and the type of meter. In other DNO regions the LLFC doesn't correspond to the customer type directly, so all LV customers might have the same LLFC, all LVS have another and so on. As a result, Ofgem's proposal would result in quite different groupings of customers being selected for the purposes of allocating the residual charge, and these groupings would vary significantly across DNO regions. We do not believe this is the intention of the TCR proposals.

We believe the most appropriate approach is to use the customer groups in the CDCM ie Domestic Unrestricted, Domestic Two Rate, Small Non-Domestic Unrestricted, HV HH Metered, etc. With this approach it might be necessary to group NHH and equivalent HH tariffs to ensure that no artificial economic incentives are introduced that encourage customers to switch between HH and NHH on the basis of lower residual charges for one segment or another (for example, Domestic Unrestricted should be in the same segment as LV Domestic HH).

Segment	DUoS Tariff
Domestic	Domestic Unrestricted Domestic Two Rate Domestic Off Peak (related MPAN) LV Network Domestic
Small Non Domestic	Small Non Domestic Unrestricted Small Non Domestic Two Rate Small Non Domestic Off Peak (related MPAN) LV Network Non-Domestic Non-CT LV Medium Non-Domestic LV Sub Medium Non-Domestic HV Medium Non-Domestic
Large LV	LV HH Metered LV Sub HH Metered
Large HV	HV HH Metered
Unmetered Supplies	NHH UMS category A NHH UMS category B NHH UMS category C NHH UMS category D LV UMS (Pseudo HH Metered)
EHV	Individual tariffs

## **Chapter 5**

**Question 10: Do you agree with the conclusions we have drawn from our assessment of the following?**

- a) distributional modelling**
- b) the distributional impacts of the options**
- c) our wider system modelling**
- d) how we have interpreted the wider system modelling?**

**Please be specific which assessment you agree/disagree with.**

There is insufficient information provided to robustly understand how the information provided led to Ofgem's conclusions. Our view considering Ofgem's evidence as presented and our own insights is the overall assessment and conclusions regarding all of the above look broadly reasonable.

## **Chapter 6**

**Question 11: Do you agree with our proposed approach to the reform of the remaining non-locational Embedded Benefits?**

Yes we support the approach in focusing on the Transmission Generation Residual Payment and the BSUoS charges.

**Question 12: Do you agree with our proposal not to address any other remaining Embedded Benefits at this stage? Which of the embedded benefits do you think should be removed as outlined in xx? Please state your reasoning and provide evidence to support your answer.**

Yes we support the approach of focusing on the Transmission Generation Residual Payment and the BSUoS charges.

**Question 13: Are there any reasons we have not included that mean that the remaining Embedded Benefits should be maintained?**

Not that we are aware of.

## **Chapter 7: Transitional Arrangements**

**Question 14: Do you agree with our proposed approach to transitional arrangements for reforms to: a) transmission and distribution residual charges b) non-locational Embedded Benefits? Please provide evidence to indicate why different arrangements would be more appropriate.**

Only one of the proposed options looks practicable under existing change arrangements, and that is implementation in 2021 so that changes are brought in with the 15 months' notice provisions for DUoS charges. If Ofgem were to implement the changes in 2020, suppliers would only have a few months' notice of what could be significant tariff changes. This would question the whole rationale for the 15 months' notice for changes in DUoS tariffs which was

supposed to provide greater certainty to suppliers and reduce their risks to allow them to reduce prices to customers. Phasing the changes in between 2021 and 2023 adds unnecessary complexity to the process. Short notice changes to charging could be a source of business risk to us and our customers through RIIO-ED2 as we need to engage stakeholders, develop and then submit our business plan so early clarity of proposed changes will assist parties in assessing any impact on customer needs and behaviour during the next price control.

## **Chapter 8: Mindset to Position**

**Question 15: Do you agree with our mindset to decision set out? If not please state your reasoning and provide evidence to support your answer.**

No. We support segment-specific fixed charges for smaller users but for larger users the residual should be recovered on the basis of their agreed capacity. The allocation of residuals to different segments should be based on an assessment of the demand each group contributes to system peak demand. This is assessed in the current charging models and will ensure consistency between large and small users.

**Question 16: For our preferred option do you think there are practical considerations or difficulties that we have not taken account of? Please provide evidence to support your answer.**

The consultation document does not consider the practical issues associated with the billing of the resulting charges. For distribution, implementation issues are associated with the tariff setting process and there do not appear to be any significant billing impacts for DNOs in implementing these proposals. We do not believe this to be the case for transmission where significant costs are likely to be incurred to partially replicate DNO billing systems and suppliers will have to incur additional costs in invoice validation. We do not believe this is necessary and if Ofgem recommends that the NGESO continues to bill the transmission residual then it needs to undertake a detailed cost assessment of the various options to ensure any benefits that could accrue to customers are not lost in more complex industry processes.