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Dear Andrew,

Response to Ofgem's "Targeted charging review: minded to decision and draft impact assessment"

I am writing on behalf of ESP Utilities Group ("ESPUG") (comprising the licensed companies ES Pipelines Ltd, ESP Connections Ltd, ESP Networks Ltd, ESP Pipelines Ltd and ESP Electricity Ltd). We welcome the opportunity to respond to Ofgem's "Targeted Charging Review: Minded to decision and draft impact assessment" consultation paper ('the 'Consultation Paper'), dated 28th November 2018.

In summary, ESPUG broadly supports the proposals as they stand with the following observations and caveats:

- We think that as far as Ofgem's assessment is constructed, it follows the principles set down in the consultation. As always, the principles identified in the consultation need to be firmly related to the data available. While subjective assessments are inevitable, Ofgem seem to be on the right track in consistently utilising these principles in conducting assessments and determining charging outcomes.
- Residual charging is a contribution to what is essentially an unallocated fixed cost. ESPUG supports the principle that for this type of cost it makes sense to use linear sharing as an equitable allocation mechanism. The paradox is that the sharing factors are linked in some way to customer groups usually on the basis of existing data that only proxies network use. We therefore see the reforms as no more than a better approximation than we have at present, which is desirable.
- As an IDNO it has been difficult to precisely understand the impact of the proposals. This is because we do not know how they will be applied in the PDCM model used by the DNOs to set our charges. This has been outside the review but could have a material impact on us.
- The effect on competition in the connections market in the impact assessment has been a significant omission for us.
- The impact assessment that has informed this consultation and whole system modelling have only accounted for a static view of changes in the generation mix and technology adoption. By basing the Grid's Future Energy Scenarios (FES) as a

forecasting reference point, Ofgem must be careful to monitor developments within FES future scenarios that could precipitate further reform.

Finally we note that under most FES scenarios micro generation will become more significant than it is now. Network utilisation will therefore decline but access to the network will still be critical during periods of intermittency when these customers will draw power from the distributor. The way in which network charges are understood by regulators and networks will probably have to adjust. For these classes of consumers with microgeneration, network access has an *option value* even if it is not used. We ask this should be taken into consideration in the detailed design phase of the SCR.

Our detailed comments are set out in the appendix to this letter. If you wish to discuss any of the issues raised in our response or have any queries, please contact me on 01372 587500.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Seb Eyre', with a stylized flourish at the end.

Sebastian Eyre
Regulation Analyst

ANNEX

Answers to consultation Questions

1. Do you agree that residual charges should be levied on final demand only?

We agree with the logic behind Ofgem's decision. However, charging demand only will not reflect the contribution of residual costs that generation should pay especially given the uptake of micro generation is the FES is considered (i.e. "Community Renewable Scenarios" in the FES).

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 think that as far as Ofgem's assessment is constructed, it follows the principles set down in the consultation. As always, the principles identified in the consultation need to be firmly related to the data available. While subjective assessments are inevitable, Ofgem seem to be on the right track in consistently utilising these principles in conducting assessments and determining charging outcomes.

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 agree. Network economics generally shows more efficiency in networks with a higher density of connections¹. This is consistent with choosing voltage level given the sheer number of connections on the LV network.

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 agree with the approach but note that the point about residual charging is that it is a contribution to what is essentially an unallocated fixed cost. For network consumers that do not use the network as much as others within the category, the charges must be seen in the context of an option value of the potential to use the network even if the network is not utilised. An example of this would be during periods of intermittency where a customer will need to draw power from the network. This maintains equity between consumers based on this aspect of network usage.

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)?

¹ E.g. Ralph Turvey "On network efficiency comparisons: Electricity distribution" *Utilities Policy* June 2006, Volume 14 Issue 2 Pages 103-113

Yes, agree. A fundamental characteristic of residual charges is that they cannot easily be allocated to what are different customer groups with diverse characteristics. Both types of users therefore should face the same residual charges.

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

Chapter two in the consultation states the context of the review. Within it the outcome of ED-2 price control and Electricity network access projects (p11) are cited. This means there are a large number of policies that will be interacting and feeding into this review. Additionally, the adoption of different generation and energy saving technologies may also be unpredictable. Changes in either of the above will have an impact on the outcome of the review and subsequently, would impact expected outcomes regarding customer benefits from implementing either of the leading options.

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

Yes, we agree. We see the leading options as being practical to implement.

Major changes to charging methodologies will involve both extensive implementation costs and alignment of IT systems accompanied by wealth transfers between customer groups. This should not be underestimated whatever the final decision.

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.

We agree with banding based on customer segments but this may be challenging to implement. Using Line Loss Factor Classes (LLFCs) to exclusively define the customer segment/type assumes that there is a common application of this factor across the DNOs.

It follows that Ofgem need to be certain that DNOs indeed uniformly applied across the network.

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?

Our comments on the introduction of LLFC's as a segmenting tool have been described in question 8.

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.

a) Distributional modelling

Yes, with some caveats.

For example, using a theoretical capacity of 18kVA for each connection based on the fuse size seems sensible but would have its limitations as that is not the capacity that would actually be used at peak times.

b) The distributional impacts of the options

We see no reason why the impacts are not accurate within the terms of the model.

c) Our wider system modelling

As we have stated previously, the diversity of generation and energy efficiency technologies create a very high level of speculation in the long term. This needs to be adequately accounted for.

d) How we have interpreted the wider system modelling

As in c, the interpretation is sensible within the model's own terms. It should be noted however, that the National Grid Future Energy Scenarios are updated as new developments occur and are subject to fluctuations. This should be taken into account in Ofgem's decision making.

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

No comment.

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.

No comment.

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

No comment.

**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.**

We agree with early implementation. The cost benefit analysis suggests that early implementation is preferable on table 11 (p84).

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

We broadly agree with the minded to decision. However, we see some issues that need to be fully considered

- Differences in cost formation different elements of the residual charges.
- Ability to accurately target consumers through existing data
- Issues associated with excluding generation customers from residual charges

It follows that the potential change outlined in this consultation is simply a better approximation to charging residual charges.

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

We see no further difficulties that we have not already been discussed in the response.

We note that the impact on IDNOs has not been a part of this consultation but could clearly have played a part within the wider consideration of the document. The lack of data for us to review allocation between DNOs and IDNOs is an issue during this consultation but we do support the economic rationale for the sharing of residual costs. Furthermore the impact on competition in the connections market more generally does not appear to be taken into consideration. We would welcome engagement with Ofgem and their agents (Frontier) on this issue.