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Dear Andrew,

I am writing in connection with Ofgem's Targeted Charging Review minded-to decision and draft impact assessment, issued on November 28<sup>th</sup> 2018.

The Scottish Energy Strategy (our Strategy) sets out our vision for the future energy system in Scotland.<sup>1</sup> It articulates a vision built around our priorities, many of which are in line with wider Ofgem priorities, and in tune with the wider direction of travel across the UK. Scotland's electricity networks will play a vital part in delivering our Strategy, and the transition towards this low carbon future. It is crucial that they develop in a way that supports our ambitions, allowing us to deliver on our commitments to Scotland and support the decarbonisation of the energy system across Great Britain.

As indicated at Ofgem's 'Future of Energy' conference, we will soon be publishing a Vision for Scotland's Gas and Electricity Networks. This will set out in detail how we think our energy networks need to develop, in a way which is consistent with the priorities in our Energy Strategy. Maintaining a fit for purpose regulatory framework that supports the changes we have already seen, and will continue to see, in terms of how energy is generated and consumed, is a vital part of this. This includes ensuring fair and proportionate network charging outcomes that balance value for consumers with the need to deliver a sustainable future.

We agree that current arrangements need reform, and with the high-level rationale for change. Electricity networks are important in ensuring that reliable and increasingly low carbon electricity is available to all households across Scotland and to businesses

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<sup>1</sup> The Scottish Energy Strategy is available here:  
<https://www.gov.scot/Publications/2017/12/5661/downloads>.

across the economy. However, we feel that Ofgem should revisit some of its analysis and thinking around ‘fairness’, and how residual network charges are shared between different groups of consumers.

We are also concerned that the consultation’s proposals related to changing embedded benefits are at odds with both Scottish Government and UK Government policy. The proposals have the potential to undermine the development of community renewables, and dampen incentives to invest in renewable energy and storage. This risks reducing the ability of the Scotland, and the UK to deliver against decarbonisation targets.

We provide some specific comments below.

### **Changes to residual charges**

All energy users who benefit from the network should pay for the network; however, it is also important that network charging considers the issues of fairness and equality. As Ofgem notes, the current system benefits those who are able to modify their behaviour and consumption to avoid charges at the expense of those who don’t have the same means, and that, without action, this problem would be exacerbated over the coming decades.

#### *Low consuming users*

Ofgem notes that in the short term this could mean that certain groups of consumers, particularly those whose consumption is lower, will pay more than they do today in order to prevent them from paying an increasingly higher share of the costs in the long term. This group could contain users with onsite generation, or those with a second or holiday home, where increased contributions to meeting residual network costs would be appropriate. However, we think that more should be done to segment these groups to better understand the short term impact on low and vulnerable users.

Data contained in the National Energy Efficiency Data-Framework (NEED)<sup>2</sup> show that those with low household incomes in Scotland (as well as in England and Wales) tend to use substantially less electricity than the average. Consumers in this group will therefore be more likely to end up paying more than they do today, while those with higher incomes will likely pay less. For example, for households with the lowest incomes in Scotland (less than £15,000 per year) the median electricity usage is 2,500 kWh per year compared with 5,400 kWh for households with the highest incomes (£150,000 or more).

A central principle of our Strategy is that our transition to a low carbon economy should be inclusive. We believe as a result that Ofgem needs to give greater consideration to the impact of its proposed options on low income households.

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<sup>2</sup> <https://www.gov.uk/government/collections/national-energy-efficiency-data-need-framework>

### *Economy 7 customers*

Scottish households with an Economy 7 meter are much more likely to be a prepayment customer than standard gas and electricity users. According to statistics published by BEIS, 35% of Economy 7 customers in Scotland use a prepayment meter compared with 20% of those with a single rate electricity meter.<sup>3</sup>

Given that prepayment customers tend to include larger numbers of those considered vulnerable, we do not agree with a reform which sees these customers face a higher cost for non-cost reflective charges compared with other households. The aim of the residual charge is to recover allowed revenue in a way that avoids distortions, and which is broadly considered fair. Access to electricity is rightly considered an essential service in the UK, and differentiating between households based on their metering arrangements appears to breach the principle of fair allocation of a non-cost reflective charge.

Finally, we are moving towards a future where smart meters will remove the clear distinction between unrestricted and two rate meters and open up the opportunity for a wide range of time of use tariffs.<sup>4</sup> Grouping all domestic customers together will maintain the three principles of the TCR by keeping the system simple and understandable, in a way which is fair to all domestic customers, and which reduces incentives to arbitrarily change between metering arrangement.

### *Non-domestic consumers*

Ofgem's proposed reforms will result in businesses which have invested in storage of onsite generation facing higher costs. Again, while we understand the rationale for the proposed changes, we are concerned about the impact that this will have on some of these businesses, particularly those who may still be bearing the cost associated with installing their onsite generation.

We also question whether the segmentation proposed under the fixed charge option is appropriate for non-domestic customers. One striking example is the charges faced by extra high voltage and transmission sites. Ofgem notes that, under fixed charges, sites covering a significant range of sizes (from 2 MW to 200 MW) will pay the same, compared to the outcome under the agreed capacity option where a 2 MW site would pay around £25,000 per annum and a 200 MW site would pay around £2.5 million per annum. The vast difference in outcomes between the two options presented suggests that Ofgem should give more thought to the fairness and proportionality of its recommendations.

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<sup>3</sup> <https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-price-stastics>

<sup>4</sup> We understand that customers with economy 7 meters and other restricted meters are facing a delay in when they are able to have a smart meter installed, however we do not think this justifies a different approach to network charges for these customers given the desire to have a charging regime that is future-proof. In addition, industry failure to deliver the technical solutions required to install smart meters for these customers already places them at a disadvantage as they pay a share of the policy costs through their energy bills but are unable to reap any of the benefits.

## **Changes to embedded benefits**

We are concerned that Ofgem's proposed changes to embedded benefits fails to strike an appropriate balance between lower costs to consumers and sustainability, and fail to recognise the important role that incentivising renewable generation plays in protecting present and future consumers. We believe that Ofgem should reconsider the cumulative impact of its proposals here, and in related workstreams, and update its analysis accordingly.

Our Energy Strategy underlines the vital continuing role of renewable electricity generation in achieving our energy demand and decarbonisation ambitions. We believe that meeting our goals will require the continued development of our huge renewable resource over the coming years, and require the installation of substantial new or repowered capacity in the right locations across Scotland. Whilst these are Scottish targets, the growth of renewables in Scotland is helping to decarbonise the wider GB electricity system, supporting the objectives of UK Government.

Ofgem's proposed changes to BSUoS embedded benefits and payments will undoubtedly have a negative effect on decisions to invest in new distribution connected capacity; this is especially true for onshore wind, where the sustained lack of a support framework means that investment decisions are already extremely marginal.

We urge Ofgem to consider more fully the effect of its proposals on the incentives to invest in distribution connected renewable generation, particularly in Scotland, and the consequences of this. Removing incentives in this area, or creating disincentives, risks Scotland and Great Britain's ability to meet binding carbon reduction targets, which would have a long-lasting detrimental impact on consumers.

Ofgem's analysis recognises that some projects could be cancelled as a result of the reform, and highlights that this should not have a detrimental impact on security of supply. However, we think that Ofgem needs to consider in more detail the sustainability implications of its decision. We note that in the detailed annexes, analysis shows that carbon emissions will rise and we would like to see this taken into account when making a decision. This is particularly important in Scotland where our support for renewables at all scales has led to substantial growth in capacity and a major contribution to both Scottish and UK decarbonisation. Our ambition is for this to continue, with small and medium distribution connected generation representing a major part of likely future growth.

We would also like to record our support for the principles set out in the response to this consultation submitted by Highlands and Islands Enterprise. The Highlands and Islands of Scotland, together with other rural areas such as Dumfries and Galloway and the Scottish Borders are home to the most productive wind farm sites in the UK and have the resource to supply significantly more renewable electricity from on and offshore wind. Many communities have taken advantage of this and embraced renewable generation, something that we strongly support. The proposed reforms could have a significant impact on the viability of these projects, with detrimental consequences for the communities involved. We urge Ofgem to consider this more fully.

We remain very interested in the proposed reforms to network regulation, investment and innovation needed to support the energy transition, and wish to remain closely engaged with Ofgem as these processes and debates continue to evolve.

Kind regards,

**Leigh Rafferty**

Head of Electricity Markets and Regulation Policy