

Andy Burgess
Deputy Director, Electricity Charging and Access
Ofgem
10 South Colonnade,
Canary Wharf,
London,
E14 4PU

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Dear Andy

Future Charging and Access programme – consultation on refined residual charging banding in the Targeted Charging Review

Thank you for the opportunity to respond to your open letter of 3 September on Ofgem's Targeted Charging Review (TCR). We offer our comments below on the refined residual charging banding proposals and the additional renewables deployment sensitivity analysis. Our networks business, SP Energy Networks is responding separately from its perspective as a transmission and distribution network licensee.

Refined residual charging banding proposals

We raised a number of concerns in our February 2019 consultation response about the practicability of using LLFCs as the basis for residual charging, and we are therefore pleased that Ofgem has given this further consideration and come up with an alternative proposal. In general we think the proposal to base charges on voltage levels and agreed capacity or net volume levels is likely to give rise to fewer anomalies than LLFCs (eg where similar customers face different charges) and potentially fewer administrative issues (eg where customers seek re-categorisation of their connection).

We have a number of detailed comments:

- **Impact on non-domestic consumers** – there is a risk that non-domestic customers will be unfairly impacted if movement between bands can only be done periodically in line with regulatory price controls (ie every five years). If non-domestic premises have a change of usage, for example from laundrette to a charity shop, with considerably reduced consumption, the new tenant could be left in the previous tenant's band for a number of years.
- **Impact on vulnerable domestic consumers:** It seems likely that the proposed reforms will have a detrimental impact on a proportion of vulnerable consumers. Whilst this is not a reason to hold back from the reforms, Ofgem needs to identify in advance which vulnerable consumers will be most severely affected and consider what alternative policy levers could be used to mitigate the impact.

- **Net volume at LV:** we are unsure how net volume is proposed to be defined, but if it is import volume minus export volume, we would question why it is appropriate to net off the export volume. Referring to the illustrative charges in Ofgem's Figure 3, this suggests that non-domestic customers towards the low end of the 5,000-20,000 kWh band could be incentivised to use behind the meter generation to drop them into the 0-5,000 kWh band, saving £164 per annum in residual charges. This incentive seems contrary to the TCR principle of avoiding distortions to end user behaviour. In addition, we would question how (under current arrangements) suppliers would be in a position to calculate net volumes without having access to export data, which may be retrieved by another supplier for the purpose of the Smart Export Guarantee.
- **Implementation date:** Ofgem's May 2019 open letter¹ suggested three preferred implementation dates for residual charging reform: April 2021, phasing between 2021 and 2023, and April 2023. Given the significant changes that Ofgem is proposing to the charging basis and the number of complex issues still to be resolved (including the basis for domestic charging), we think that implementation should be no earlier than April 2023. It is also relevant to note that in the non-domestic supply market prices can be fixed several years in advance, meaning that suppliers may need up to four year's notice to be able to reflect new network charging arrangements in such contracts.
- **Operating System(s):** delivering the TCR charging band proposals will be considerable and complex changes for the industry. We would recommend that discussions are started now on how these changes will operate in practice. Data sources and charging methodologies have to be controlled from a single source to allow fair and equitable access for all industry participants. This should include considering now the industry code mechanisms required to facilitate this. We would note that DNOs currently receive NHH LV consumption data on an aggregate basis only, whereas individual customer data would be required for calculate supplier charges.
- **Clarity of proposals:** Although we welcome Ofgem consulting on its revised proposals at this early stage, we would note that the detail is quite difficult to follow, particularly for people who have not been closely involved to date. We would encourage Ofgem to consider how its proposals can be made more accessible to non-expert stakeholders at the next iteration, and ahead of moving into the code modification process.
- **More complex sites:** Ofgem invites views on complexities or distortions that may be associated with applying its proposals to complex sites (eg with multiple MPANs), iDNOs and private networks. We agree it will be important to consider these issues, particularly for domestic customers on electric heating systems who are more likely than average to be fuel poor. We will be pleased to comment on more detailed proposals in this regard, including from the perspective of metering arrangements that are specific to Scotland. There is still some uncertainty as to how different

¹ <https://www.ofgem.gov.uk/ofgem-publications/151657>

restricted meter types will be replaced by smart metering and it may be difficult to reach a final view on Ofgem's charging proposals until this is better understood.

Renewables deployment sensitivity analysis

We welcome the fact that Ofgem has commissioned this additional sensitivity analysis and published it for feedback ahead of its final decision. Given the increasing focus on decarbonisation it is essential that the impacts of proposed policy changes on renewables deployment and wider system costs are properly assessed.

We have two high level comments on the outputs of the Frontier sensitivity analysis of the embedded benefits reforms. First, in light of recent Government commitments to Net Zero, we think it is untenable to maintain the position that the Steady Progression (SP) scenario is the central case and Community Renewables (CR) the 'alternative' case. The level of decarbonisation ambition implicit in SP is completely incompatible with the Government's targets. Ofgem's final decision should be based predominantly on the impact assessment for CR, with the SP impact assessment used to test specific sensitivities if required.

Second, as expected, the new analysis shows an entirely different balance than before between system cost impact and consumer cost impact. Previously, Ofgem was able to argue that the reforms provide substantial consumer savings for a marginal increase in system costs. But in Frontier's latest assessment system costs – a measure of overall system efficiency (and arguably long term consumer benefit) – are now significantly increased (by £4bn NPV in the CR scenario), which is more than twice the magnitude of the reduction in consumer costs (£1.92bn). This suggests that the embedded benefits reforms will be value destroying for the UK economy as a whole, and we find it difficult to understand how Ofgem could justify proceeding with embedded benefit reform on that basis.



Richard Sweet
Head of Regulatory Policy