Judith Ross
Ofgem
9 Millbank

London

SW1P 3GE

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Dear Judith,

**Targeted Charging Review: a consultation**

Scottish Renewables is the representative body for the renewable energy industry in Scotland, working to deliver a low-carbon, secure energy system, integrating renewable electricity, heat and transport at the lowest possible cost.

We have been closely involved in recent work to review charging arrangements for embedded generators and have engaged proactively in the debate around the transition to a smart, flexible energy system.

Creating a level playing field is central to this transition and while we support Ofgem’s stated principle to reduce distortions and attempt to create fair, level playing field across all parties[[1]](#footnote-1) it is our view that that the scope of the review as set out within this consultation is too narrow and could target specific users of the network. – amounting to a collection of two discrete, code specific issues (triad avoidance behaviour, LV/HV distribution residual charges and storage charging arrangements).

Overall it is our view that any review of charging arrangement s must acknowledge that there are very significant, complex and long standing differences between transmission and distribution connections.

Changes to the charging regime must take full account of the reality of the current charging framework, including the investments made across the industry against a stable charging backdrop.

In addition, we would welcome further clarity on the key drivers within the residual element of charging

With this in mind, while we support the use of a significant code review to address the distortions that exist within the existing methodology there is some concern We therefore encourage Ofgem to;

* Set out a clear strategy for addressing network access and charging arrangements going forward.
* Seek to review, evaluate and, if necessary, amend transmission and distribution network access arrangements to ensure that future arrangements are fit for purpose.
* Followed by a code review focused on charging – to assess the implications of the conclusion of network access arrangements. The scope of the charging review should be guided by the outcomes of the network access review

Finally, it is important to consider how the principle of fairness can be best applied across all network users, reflecting the fullest possible scope and customers ability to respond to changes in charging arrangements

With this in mind, while we support Ofgems work to consider cost recovery process we would also encourage Ofgem to consider whether the costs that are being recovered (i.e. the size of the pot) remains fair.

Ofgem’s recent annual report on returns under the RIIO framework which illustrate the Return on Regulated Equity (RoRE) show that returns that are highly excessive for regulated businesses – up to 11.63% and average approximately 10%. This is set against a total equity base of £5.6bn for transmission and £7.6bn for distribution networks.

We note that the cost of equity for transmission owners is 7% and for distribution owners is 6% (6.4% for WPD). This seems extremely high for heavily regulated business within a mature and stable market like GB, and consider that Ofgem should conduct an investigation into the real cost of equity for these companies to confirm whether current levels of return under the RIIO framework are excessive.

We have set out our views in response to relevant questions from the consultation below and would be happy to contribute to any additional work arising from this consultation.

**Consultation Questions**

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| **Why we propose to review residual network charges** |
| Question 1: Do you agree that the potential for residual charges to fall increasingly on groups of consumers who are less able to take action than others who are connected to the system, is something we should address? |
| * Agree on the need to protect consumers who are less able to take action
* Requires Ofgem to consider the way that charges are recovered- need to consider if TRIAD system is fit for purpose
* Would make sense to look at the size of the pot that is collected
* Should also require assessment of the D/ T access arrangements first
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| Question 2: If so, why do you think, or do not think, action is needed? |
| * As above
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| Question 3: We are proposing to look at residual charges in a Significant Code Review. Are there any elements of residual charges that you think should be addressed more urgently? Please say why. |
| * Current scope of work would not necessarily require SCR
* A wider SCR is required and this should take a coordinated view of charging across the network
* Also requires alignment with other areas of work being taken forward both within Ofgem and across other stakeholders e.g. NGET and ENA.
* Ofgem highlight that further work is required to consider the forward looking element of the charge – but there is not site as to how this will be taken forward alongside the TCR
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| **How some network users may respond to the current residual charges**  |
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| **Experience in other countries** |
| Question 4: Are there elements of the approaches in other countries that you think could be appropriate for GB residual charges? |
| * The review of other countries experience highlights that this is not an isolated issue in the GB market
* “Traditional methods for recovering the cost of large network investments have historically been relatively simple. But those methods are breaking down as countries pursue decarbonisation policies” ([Frontier Economics](https://www.frontier-economics.com/publications/that-sinking-feeling/))
* However other countries do appear to have taken a broader look at the charging regime first, before focussing on the residual
* Another key finding is that it is important to consider if the LRMC values the benefits of DER appropriately – reinforcing the need to look at the forward looking element of the charge alongside this review
* Avoiding rates shocks has been a guiding principle for international regulators- but isn’t explicit in the Ofgem consultation
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| Question 5: Are there other approaches that you know about from other jurisdictions, that you think offer relevant lessons for GB? |
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| **Proposed principles for assessing options** |
| Question 6: Do you agree that our proposed principles for assessing options for residual charges are the right ones? Please suggest any specific changes, or new principles that you think should apply. |
| * While we appreciate and support the importance of fairness as a principle. However there is some concern with the complexity involved in trying to establish a fair solution – given the wide range of opinion that this will be exposed to.
* It is important that Ofgem should try and provide some structure as to how this will be assessed, what fairness means, and to who it should apply – consumers, investors, different types of network users
* The principle of fairness needs to be considered in the round, across all network users and reflect the fullest possible scope
* Fairness must also reflect customer’s ability to respond to proposed changes in charging arrangements.
	+ We agree that charging arrangements should encourage behaviour from system users which reduces overall system costs and minimise costs to the consumer.  However, similar to the network businesses, generators and other network users have made investment decisions and have sunk costs, at risk.  Once investments are made and plant has been installed, it is very difficult for users to reasonably respond to new charging arrangements.  For many projects, particularly those currently under construction, the proposed changes are therefore simply punitive
* With this in mind, it is important to consider how this principle would appl when considering a level playing field between transmission and distribution network users;
	+ The differences between the charging arrangements at transmission and distribution are extremely complex.
	+ For example, distribution users pay high costs up front (per MW of capacity) to connect to the electricity network compared to transmission system parties.
	+ Transmission connectees tend to have new network investment (extension or reinforcement) socialised across the entire network customer base.
	+ distribution connected parties are required to raise finance to procure these assets rather than being able to rely on the network owner’s ability to finance and build these assets.
	+ Distribution connected projects can also be exposed through the statement of works process to transmission related connection charges (and underwriting for transmission reinforcements).
	+ However, transmission connected parties are not exposed to distribution system reinforcements.
	+ distribution parities are exposed to transmission losses (albeit often a credit due to offsetting of transmission network flows) as well as distribution losses.  However, on the other hand transmission connected parties are not exposed to distribution losses even though their requirement for (and utilisation of) the distribution network is just a significant to a distribution connected party.
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| **Some options for setting residual network charges** |
| Question 7: In future, which of these parties should pay the transmission residual charges: generators (transmission- or distribution-connected), storage (transmission- or distribution-connected), and demand, and why? What proportion of these charges should be recovered from each type of user? |
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| Question 8: In future, which of these parties should pay the distribution residual charges: generators (transmission- or distribution-connected.), storage (transmission- or distribution-connected), and demand, and why? What proportion of these charges should be recovered from each type of user? |
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| Question 9: Do you support any of the five options we have set out for residual charges below, and why? |
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| Question 10: Are there other options for residual charges that you think we should consider, and why? |
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| Question 11: Are there any options that you think we should rule out now? Please say why |
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| **Benefits for smaller embedded generation, relative to other generation** |
| * We consider that a full, cross code review should be performed – spanning all network charging arrangements including forward looking charges and residual charges.
* However, we believe that fundamental changes to the charging arrangements should not be progressed until after a full review of distribution and transmission network access arrangements has been completed.
* We consider that this is particularly important in the context of ‘fairness’ principles as network costs should reflect users network access rights.
* Access arrangements must also be considered in the context of smart, flexible network arrangements to ensure that charging arrangements provide appropriate investment signals to network owners.
* Providers of flexibility will use networks in different ways to other types of network user and will result in different investment drivers and this should be reflected in network design and charging arrangements.  Overall, the ways in which these participants will use the networks will depend on the flexibility market design.  We believe that there is clear rationale to consider a review of network planning, connections and charging to understand how flexibility providers fit into the existing frameworks and that access to markets isn’t, as far as possible, distorted across transmission and distribution.
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| Question 12: Do you think we should do further work to analyse the potential effects of the charging arrangements for smaller EG (called ‘embedded benefits’)? |
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| Question 13: Do you think changes are needed to the current charging arrangements for smaller EG, and when should any such changes be implemented? |
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| Question 14: Of the embedded benefits listed in our table, do you think that any should be a higher or lower priority? |
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| Question 15: Do you think there are other aspects of transmission or distribution network charging which put smaller EG, or any other forms of generation or demand, at a material disadvantage? |
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| **Our views on residual and BSUoS charging for storage** |
| We agree with Ofgem that there is likely to be good consensus across industry about the fair treatment of storage and the charging issues (use of system, balancing and final consumption levies) can likely be managed through individual code modification processes rather than as part of lengthy code review process. |
| Question 16: Do you agree with our view that storage should not pay the current demand residual charge, at either transmission or distribution level? |
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| Question 17: Do you agree with our view that storage should not pay BSUoS on both demand and generation? |
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| Question 18: Which of the BSUoS approaches describe is more likely to achieve a level playing field for storage? |
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| Question 19: Do you think the changes in this chapter should be made ahead of any wider changes to residual charging that may happen in future? Do you agree with our view that these changes should be implemented by industry through the standard code change process? |
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| **Our approach to taking these changes forward** |
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| Question 20: We would welcome your thoughts on the potential make-up of a CCG. Please refer to the potential role, structure, prioritisation criteria and assessment criteria. |
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| Question 21: Do you agree with our proposed delivery model, including its scope? |
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| Question 22: Do you agree that our proposed SCR process is most appropriate for taking forward the residual charging and other arrangements for smaller EG discussed in this document? |
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1. <https://www.ofgem.gov.uk/system/files/docs/2016/12/smart_flexible_energy_system_a_call_for_evidence.pdf> [↑](#footnote-ref-1)