

Judith Ross
Ofgem
9 Millbank
London SW1P 3GE

12 May 2017

Dear Judith

Targeted Charging Review consultation response

Scottish Renewables is the representative body for the renewable energy industry in Scotland, representing around 270 organisations and working to deliver a low-carbon, secure energy system that integrates 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. Scottish Renewables supports Ofgem's stated principle¹ to reduce distortions and attempt to create a fair, level playing field across all parties, though we are concerned that the relatively narrow scope of the proposed review could risk unfairly targeting specific users of the network. We support the use of a Significant Code Review and would encourage Ofgem to ensure that it enables a coordinated, holistic view of charging across the network (both distribution and transmission).

Overall there is a need to acknowledge that there are very significant, complex and long-standing differences between transmission and distribution connections as part of any review of charging arrangements.

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 methodology, we would 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
- Assess the implications of the conclusion of network access arrangements in order to guide a code review focused on charging.

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

¹ https://www.ofgem.gov.uk/system/files/docs/2016/12/smart_flexible_energy_system_a_call_for_evidence.pdf

arrangements. Therefore, while we support Ofgem's work to consider the cost recovery process, we would also encourage Ofgem to consider whether the costs that are being recovered (i.e. the size of the pot) remain fair. In this regard, it is important to reflect on other fundamental cost drivers when defining the problem.

We also support the creation of a charging coordination group, which we would expect to comprise a representative mix of the full range of network users.

We have set out in the enclosed document the views of our membership in response to the consultation questions and would be happy to discuss these with you in more detail should that be helpful.

Yours sincerely,

Michael Rieley
Senior Policy Manager

Consultation Questions

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?

Question 2: If so, why do you think, or do not think, action is needed?

We support the work of Ofgem to protect consumers who are less able to take action and support the principle of fairness to ensure that all users connected to the system make a fair contribution towards the common costs of running the network.

However, it is our view that in order to achieve an enduring solution Ofgem must also consider the way in which network charges are recovered. This will need to consider if the Triad system remains fit for purpose.

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.

Scottish Renewables supports the use of a Significant Code Review (SCR) and would encourage Ofgem, when finalising the scope of the review, to ensure that it enables a coordinated, holistic view of charging across the network (both distribution and transmission). This would avoid piecemeal change which could result in considerable uncertainty for consumers and market participants.

It is important to note that, in addition to the proposed SCR, a number of other key stakeholders are taking forward activity that considers issues arising from network charging: the ENA's TSO/DSO project and National Grid's own review of charging issues should be closely coordinated and aligned where possible.

It is our view that a clear assessment of the true sunk costs of the network should be a critical element of the SCR in addition to determining whether certain elements recovered through the existing residual should be allocated to certain users or recovered through other means.

In addition to residual charges, we would encourage Ofgem to consider the following factors:

- Restrictions within the existing methodology and the impact on the residual in recovering non-locational costs
- Whether the Triad model remains fit for purpose and if other charging models could be improved to increase cost reflectivity
- How charging models could best align with the transition of DNOs to DSOs.

How some network users may respond to the current residual charges

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 is helpful as it highlights that this is restricted solely to the GB market. Overall it is clear that the traditional methods applied for recovering the costs of network investment are being challenged as technology changes and countries pursue decarbonisation policies.

However, we would also note that other countries do appear to have taken a broader look at the charging regime first, before focussing on the residual element of charging.

Ofgem should also note that residual charges in other jurisdictions' are just one part of their charging regime and cannot be considered in isolation and compared to the GB Model. With this in mind, in order to avoid unintended consequences it is important that international residual charging examples should be considered alongside work to assess the way that forward looking charges are set.

Finally, it is clear that avoiding rates shocks has been a guiding principle for international regulators; however this is not apparent within the current consultation.

Question 5: Are there other approaches that you know about from other jurisdictions, that you think offer relevant lessons for GB?

There is some concern over the selection of countries used by consultants TNEI. While the analysis provided is helpful we would encourage further targeted and systematic literature review, including the following sources:

- Poyry (2009), Optimal Network Tariffs and Allocation of Costs (Norway);
- Brattle Group (2014), Structure of Electricity Distribution Network Tariffs: Recovery of Residual Costs (International Study).

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, establishing what is deemed to be a fair solution is likely to be extremely complex given the wide range of opinion to which this process will be exposed.

It is important therefore that Ofgem attempts to provide some structure as to how this will be assessed, what fairness means and to whom it should apply: consumers, investors, different types of network users, etc.

Fundamentally, the principle of fairness should be considered across all network users and reflect the

fullest possible scope, as well as reflecting 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 minimises 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 apply while seeking to achieve a level playing field between transmission and distribution network users. Factors that should be considered include the following:

- 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 parties are exposed to transmission losses (albeit often a credit due to offsetting of transmission network flows) as well as distribution losses. However, transmission connected parties are not exposed to distribution losses, even though their requirement for (and utilisation of) the distribution network is just as significant as a distribution connected party.

In addition to the principle of fairness we would also encourage Ofgem to include transparency and predictability as key principles.

The residual should serve to recover the true sunk costs of the network and it is currently not transparent what costs are 'common' and are recovered via the residual charge.

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?

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?

Question 9: Do you support any of the five options we have set out for residual charges below, and why?

Question 11: Are there any options that you think we should rule out now? Please say why

It is our view that the response to these questions should be informed by a holistic review. All options proposed should have sufficient examination through the SCR.

Benefits for smaller embedded generation, relative to other generation

It is our view that a full, cross-code review should be performed, spanning all network charging arrangements including forward-looking charges and residual charges.

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 is not, as far as possible, distorted across transmission and distribution.

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’)?

Question 13: Do you think changes are needed to the current charging arrangements for smaller EG and when should any such changes be implemented?

With respect to the Transmission Demand Residual (TDR) it is our view that CMP264/5 should only be considered as an interim solution and the SCR should be tasked with finding an enduring solution that tackles the route cause rather than the symptoms of the defect.

It is our view that this should be informed by independent analysis to determine the impacts of charging, grid and market access arrangements - identifying the differences between transmission and distribution connected generation.

Finally, we would note that the consultation does not consider ‘benefits to non-EG’, such as SO market access or shallow transmission connection charges.

Considering all of these arrangements together is essential to enabling the development of a level playing field.

Question 14: Of the embedded benefits listed in our table, do you think that any should be a higher or lower priority?

There is some concern with the statement within this consultation that smaller embedded generators do not pay BSUoS. In fact, at grid supply points (GSPs) where suppliers are incurring charges due to exports, these charges are levied back onto embedded generators.

In addition we note that a wider review of BSUoS arrangements is planned through the ‘flexibility and

future strategy work stream'. BSUoS arrangements for embedded generators, including net charging principles, should therefore be considered as part of this review.

We would also encourage BEIS and Ofgem to provide some formal clarity on how DSO balancing costs should be recovered now and in the future.

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?

Embedded generators experience disadvantages in lack of access to ancillary services provision, constraints management – firmness of access and payment arrangements, deep connection charges etc. Network charging arrangements considered in isolation from these issues are likely to create unintended consequences and exasperate market distortions and any inefficient costs for consumers.

A revision of ancillary services is a particular priority as there is a bias towards large conventional fossil fuelled generators against renewable energy generators, storage and DSR in the way that ancillary services are described and procured.

Our views on residual and BSUoS charging for storage

Question 16: Do you agree with our view that storage should not pay the current demand residual charge, at either transmission or distribution level?

Question 17: Do you agree with our view that storage should not pay BSUoS on both demand and generation?

Question 18: Which of the BSUoS approaches described is more likely to achieve a level playing field for storage?

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?

We understand that there is some consensus emerging across parts of industry about the fair treatment of storage and the charging issues (use of system, balancing and final consumption levies) which can likely be managed through individual code modification processes rather than as part of lengthy code review process.

We would note that storage is not the only provider of flexibility; others include DSR and generation. With this in mind, it is important to consider that any outcome which is not technology agnostic could lead to unintended distortion. Therefore, there is some concern that proposed changes could lead to undue discrimination.

In addition we have specific concerns with the proposals to change the treatment of BSUoS charging for storage. Overall we do not agree that BSUoS charges for storage should be considered outside of a wider consideration of BSUoS costs.

With this in mind, we do not believe either approach would be likely to achieve a level playing field for

storage.

Our approach to taking these changes forward

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.

Question 21: Do you agree with our proposed delivery model, including its scope?

We strongly support the creation of a charging coordination group (CCG). This group should comprise a representative mix of the full range of network users including - but not limited to - trade associations, generators (renewable and non-renewables, large and small suppliers), customers/customer groups, aggregators, storage operators, network and system operators, etc.

It is essential that the CCG provides transparency and coordination with other areas of activity on network charging, for example:

- The Energy Network Associations TSO-DSO project
- National Grid's review of charging arrangements
- BEIS/Ofgem's smarter flexible energy system consultation.

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?

With this in mind, while we support the use of an SCR to address distortions and attempt to create a fair, level playing field across all parties², we are concerned that the relatively narrow scope of the proposed review could risk unfairly targeting specific users of the network.

Overall, there is a need to acknowledge that there are very significant, complex and long-standing differences between transmission and distribution connections as part of any review of charging arrangements.

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.

² https://www.ofgem.gov.uk/system/files/docs/2016/12/smart_flexible_energy_system_a_call_for_evidence.pdf