



Making a positive difference
for energy consumers

Mo Sukumaran
Chair: EDCM review group

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Dear Mr Sukumaran,

EDCM review – Ofgem views

Introduction

Last year a group under your chairmanship carried out an industry review of the Extra-high voltage Distribution Charging Methodology (EDCM), the approach used to calculate electricity distribution charges for those customers connected to the distribution network at the extra high voltage levels.¹ You separately shared the report with us. Subsequently, these findings have been shared publicly via the Energy Network Association's website. We have reviewed the report and its seven recommendations. This letter provides Ofgem's views to incorporate into the next stage of work in this area.

We welcome this work, which provides a valuable contribution to thinking on the future direction of electricity charging arrangements.

It is for industry to take the next steps on the recommendations of this report completed under open governance. We recognise however that it is useful to provide our views/comments on the recommendations to inform next steps. These next steps are likely to vary for different recommendations and might include:

- Developing and submitting change proposals to the DCUSA panel,
- Further policy discussion, for example within methodology issues group (MIG) sessions, and
- No action.

In this letter our views are given without prejudice to any decision Ofgem needs to make at a later date.

We recognise that the report has been available for a number of months. We think there is some advantage in considering the review now. First, there remains time for the CDCM review to consider this response where appropriate. Second, our views can reflect our work with Government on how charges might be influenced by the development of a smarter, more flexible energy system.

We think it is important that in the next steps of this work consideration is given to the treatment of new technologies such as storage under the EDCM. There are a number of issues which need to be addressed with regards to storage in particular. One issue which merits consideration is whether storage connections should be treated as intermittent or

¹ As set out in Condition 13B.6 of the standard distribution licence.

non-intermittent. There is no guidance on this in the EDCM and this creates a risk of discrepancies in treatment by different network operators. We think consideration should be given to the impact of storage users on network costs compared to other users, and any potential competition impacts associated with this. This is an issue which we would welcome views and proposals from the EDCM review in its next steps.

We outlined in our open letter on charging arrangements for embedded generation² that we will consult on other elements of embedded benefits, including some aspects of BSUoS; and allocation of sunk/fixed costs, including for storage and 'behind the meter' generation. We welcome input from the DCMF as this work progresses, and will be seeking formal views on these issues later this year.

As a general observation we note that the review examined current issues associated with the EDCM and has made suggestions as to how these could be resolved. We would encourage any next steps to incorporate a more forward looking focus, capturing issues such as the rise of storage connections, demand side response, more distributed generation and a greater operational role for distribution network operators.

We welcome the EDCM review report and view this as a first step. To take some or all of these recommendations forward will take considerable commitment from industry to arrive at practicable solutions. Although some recommendations could be taken forward as DCUSA change proposals in time for implementation (if approved) in charging year 2019-20, others are unlikely to be able to be implemented before charging year 2020-21. Some recommendations may require more than DCUSA changes, changes to licence conditions may be necessary for example. We therefore welcome further work on next steps commencing in a timely way, and should industry identify licence changes that may be necessary, to engage with us at an early stage in the process.

The annex to this letter contains our views presented against each of the seven recommendations set out in your report.

Yours sincerely,

Andrew Self
Head of Electricity Network Charging

² <https://www.ofgem.gov.uk/publications-and-updates/open-letter-charging-arrangements-embedded-generation>

Annex: EDCM review group's recommendations and our views/comments

Below we set out our specific views / comments on the seven recommendations made by the review group.

a. That 'Charge 1' which sets charges based on future reinforcements is removed and replaced with an alternative method of calculating a unit charge.

Where achievable, we want to encourage customer actions at the extra high voltage level that help DNOs minimise future infrastructure costs (where this is feasible without undermining the delivery of necessary outputs for customers). We agree that the review shows that there are issues with the effectiveness of the intended price signal in influencing decisions by customers. The report points out that Charge 1 accounts for a small proportion of overall charges and that the price signals can easily be overridden by other charges and factors. We believe more work is needed considering options for a replacement to Charge 1, if appropriate. This work should consider the wider financial incentives including those associated with connections. If you are of the view that no replacement is either necessary or viable then this should also be made clear.

This is consistent with our DCP206 decision in May 2015 where we stated, '*we note that some respondents indicated that even if Charge 1 in its current form was found to be defective consideration should be given to replacing it rather than its removal so as to maintain the locational and time of use price signals.*' The report stopped short of suggesting what Charge 1 could be replaced with and what would be the supporting rationale.

Any firm proposals for the removal of Charge 1 and its replacement would need to be supported by strong evidence. At this time, however, we are concerned that proposing to remove Charge 1 before full consideration of any potential replacement charge may not be in the best interests of consumers.

b. A single EDCM methodology should be considered based on Network Use Factors (NUFs) for setting locational charges. This should include an assessment of ways of reducing volatility and also allocating some of the NUF charges to unit rates and whether or not this would be compatible with Time of Use (ToU) or real time charging.

We see merit in streamlining the EDCM. At the time the EDCM was introduced the DNOs did not reach consensus on one method (LRIC based or FCP based pricing). We encourage the DNOs and other parties to give further consideration to a single methodology. We believe that this is an issue largely for industry to address but any proposals for change would need to be supported by evidence that they would be in the best interests of consumers.

c. An arrangement similar to that used in CDCM (Time of Day (ToD) or Seasonal Time of Day (SToD)) should be considered to reduce the probability of major shifts of demand between time periods. Moving to unit based charging could create some instability in DNO income recovery, so the spread of the time bands should also be considered.

We have been considering similar issues in our forthcoming call for evidence on a smarter, more flexible energy system. We also note this is also being considered as part of the CDCM review. We believe that this aspect of the review may be best reserved until the outcomes of these other activities are clearer.

d. The allocation of other costs should be reviewed so as to allocate them as closely as possible to the group of customers which benefit from them or historically caused them.

Any proposal in this regard should seek to strike an appropriate balance between improvements in cost reflectivity and other code objectives.

e. Ways of making available the EDCM models should be investigated so that as far as possible the basis of charges is transparent to customers, publication of an EDCM model needs to satisfy confidentiality requirements, which has been one of the concerns raised.

We support the desire to make the methodology more transparent but we would need to be confident that it can be done without compromising confidentiality obligations as set out in the Utilities Act 2000 (as amended).

f. Alternatively a development of a new, all-encompassing methodology, to replace both the EDCM and CDCM should be considered.

The current trend towards decentralised energy has highlighted distortions across the charging methodologies across different voltage levels, and there is a strong case to remove these distortions.

Developing a new all-encompassing methodology would be a major departure from the current arrangements and could disrupt a large number of customers (dependent on the nature of the single methodology). Although a combined model may be possible we believe that such a model should maintain site specific charges for EHV designated consumers. This may result in the model, or a component of it, to be retained as confidential to the DNO. This aspect should form part of the ongoing review of the CDCM. To take this recommendation forward would require extensive work but could provide an opportunity to address many other issues associated with the CDCM and the EDCM, not least of which being the boundary between the two methodologies.

g. Consideration should also be given to exploring options for generation credits, as small generators in the CDCM currently receive credits regardless of whether they are intermittent or non-intermittent and embedded generators benefit by a reduction in their demand charges.

We recognise that this is part of a much bigger issue. We are undertaking analysis as part of our forthcoming call for evidence on a smarter, more flexible energy system and it is also likely to be influenced by the outcome of the industry led CDCM review. For this to be taken forward we would expect it to include a detailed consideration of recent industry developments, notably the rise of storage and the concerns raised with respect to how storage operators are charged for the use of the distribution networks.