

Pants On Fire, episode 1

by Franck Latrémolière on Friday 19 June 2015

1. Ofgem's decision on DCP 206 contains the words quoted in exhibit 1.

Exhibit 1 Ofgem's claims

The proposer of DCP206 considers that Charge 1 creates several defects:

- As the charges are based upon potential future reinforcement costs, consumers may be paying charges based on costs that may not actually be incurred by the DNO.
- Alternatively, consumers may over-contribute to reinforcement costs by paying in advance through Charge 1 and again, once the reinforcement is triggered, through consumer contributions in their connection charges.
- Consumers may also experience changes in charges that are a result of activities of other consumers, rather than changes within their control.

2. Exhibit 2 shows what the change proposal form said about defects of charge 1.

Exhibit 2 Defects of charge 1 according to DCP 206 change proposal form

This change proposal seeks to address a defect in the EDCM methodologies. The defect is that the charge 1 elements of the EDCM could impose charges that reflect future hypothetical investments needed to meet the growth in demand of other customers. For example, these charge 1 elements could require a current EDCM customer to pay for some of the costs to the DNO of supplying future EDCM or CDCM customers. This application of charge 1 is not cost reflective. It might lead to unfair charges in cases where the costs underpinning charge 1 are not needed or used to distribute electricity, now or in the future, to an EDCM demand customer who would be paying charge 1.

3. Exhibit 3 shows how the DCP 206 change report introduced the objectives.

Exhibit 3 Introductory section in the DCP 206 change report

2.2 The CP form states that the defect is that the Charge 1 elements of the EDCM could impose charges that reflect future hypothetical investments needed to meet the growth in demand of other customers. It is further explained that these Charge 1 elements could require a current EDCM customer to pay for some of the costs to the Distribution Network Operator (DNO) of supplying future EDCM or Common Distribution Charging Methodology (CDCM) customers.

2.3 According to the CP form, the application of Charge 1 is not cost reflective, which may lead to unfair charges in cases where the costs underpinning Charge 1 are not needed or used to distribute electricity, now or in the future, to an EDCM demand customer who would be paying Charge 1.

What's wrong with the first paragraph in exhibit 1?

4. The proposer of DCP 206 was E.ON, who submitted the proposal following discussions at the DCMF Methodologies Issues Group and Ofgem's refusal¹ to designate me as a person that may raise a similar change proposal.
5. It seems a misrepresentation to say that E.ON "considers" anything in relation to DCP 206. By raising the change proposal, E.ON was only trying to make open governance work. I do not recall E.ON staff expressing any views on the merits of the proposal.

What's wrong with the second paragraph in exhibit 1?

6. Ofgem alleges that the proposer saw as a defect of charge 1 that "consumers may be paying charges based on costs that may not actually be incurred by the DNO".
7. Whilst Ofgem's words are true, this feature is not something that a competent economist could consider a defect in a charging methodology. In order to achieve fairness or cost reflectivity, it is frequently necessary to base charges on modern equivalent notional costs, or on notional efficient costs, all of which may differ materially from actual or reasonably foreseeable costs.
8. What the change proposal identifies as a defect of charge 1 is not that it merely relates to hypothetical costs or future hypothetical investments. The defect stated in the change proposal is that charge 1 reflects investments that are *needed for meet the growth in demand of other customers*.
9. The change proposal reiterates the point in the next sentence: *charge 1 elements could require a current EDCM customer to pay for some of the costs to the DNO of supplying future EDCM or CDCM customers*. There is no complaint in here about paying for hypothetical costs: the complaint is about paying for costs which are related to supplying other customers.
10. The change report accurately restates the arguments in the change proposal.
11. In summary:
 - (a) The change proposal and change report do not make the allegation that Ofgem invented in the second paragraph in exhibit 1.
 - (b) Ofgem falsely accuses the proposer of DCP 206 of making an obviously illogical argument that does not appear in the change proposal or change report.
 - (c) Ofgem's decision does not acknowledge the legitimate criticism of charge 1 that is included in both the change proposal and the change report.

¹ <http://dcmf.co.uk/ofgem-refusal-to-designate-for-dcp-on-mig-issue-63.html>
A topic for a future episode of Pants On Fire, maybe.

What's wrong with the third paragraph in exhibit 1?

12. Ofgem alleges that the proposer saw as a defect of charge 1 that “consumers may over-contribute to reinforcement costs by paying in advance through Charge 1 and again, once the reinforcement is triggered, through consumer contributions in their connection charges”.
13. The change proposal's identification of the defects of charge 1 says no such thing.
14. The change report does identify a double-charging issue in its section on the relevant objectives. This is reproduced in exhibit 4.

Exhibit 4 Double charging according to DCP 206 change report

If an EHV customer has been paying DUoS with a high locational element and a new customer connects to the same node, the new customer may drive reinforcement. Where this is the case the new customer will fund a large portion of the reinforcement through a customer contribution and this will be in addition to the contributions made by the existing customer through their DUoS charge. Alternatively, if the existing EHV customer increases their import capacity they will drive the reinforcement and pay a customer contribution. At higher network levels it is likely that the customer contribution will pay for all or most of the reinforcement costs. This will be in addition to the reinforcement costs that the customer has already paid for through their use of system charge and consequently the customer could pay for the same reinforcement twice.

15. It is possible that Ofgem has correctly understood the argument in exhibit 4. However, Ofgem's specific wording suggests that this might not be the case, because Ofgem talks about consumers collectively over-contributing. In fact, two separate issues arise from exhibit 4:
 - (a) Customer A might be charged (through charge 1) for a reinforcement to accommodate customer B, and that reinforcement might also be covered by customer B's connection charge.
 - (b) In some circumstances, a single customer might be double-charged (through charge 1 and through a connection charge) for the same network reinforcement.
16. By using a collective formulation, Ofgem appears to ignore the second issue. If Ofgem took its duty to protect the interests of customers seriously, it would not use the collective formulation: it would ask itself whether the interests of each customer are properly protected, insofar as in reasonably practical, by its regulatory actions.

What's wrong with the third paragraph in exhibit 1?

17. Ofgem alleges that the proposer saw as a defect of charge 1 that “Consumers may also experience changes in charges that are a result of activities of other consumers”.

18. The change proposal's identification of the defects of charge 1 says no such thing. I cannot see the argument anywhere in the change proposal or change report — it seems to have been invented by Ofgem.
19. Ofgem's words are true, but this feature is not something that a competent economist could consider a defect in a charging methodology. In order to achieve fairness or cost reflectivity, it is frequently necessary to allocate common costs or assets between different customers; this inevitably leads to the charges to one customer being dependent on the consumption of other customers. That such interactions should happen is no indication of a defect in a charging methodology.
20. As in the second paragraph of exhibit 1, in the fourth paragraph of exhibit 1 Ofgem falsely accuses the proposer of DCP 206 of making an obviously illogical argument.

Why?

21. The phrase "straw man" is sometimes used to refer to the logical fallacy which consists in falsely describing one's opponent's position as something different and less robust to what it is (the man of straw), and then attacking the fictional position.
22. It is a cowardly way of putting up a pretence of argument in circumstances where you are either wrong or not equipped with the skills to address the argument actually made. It is also an accurate description of the Ofgem conduct outlined in this episode.