Highlands and Islands Enterprise
Iomairt na Gàidhealtachd 's nan Eilean

TCR@ofgem.gov.uk

4 February 2019

Dear Andrew

Targeted Charging Review: **Minded to decision and draft impact assessment**

Thank you for the opportunity to respond to the above consultation.

The Scottish Highlands and the Islands off the north and west coast represent a large geographical region. The region has a low population density with many pockets of population spread across areas that are often remote. The region is home to a large volume of renewable energy power stations – from small scale, local developments to very large commercial installations. There are many more sites across the region that could be exploited to provide yet more cost effective, low carbon, renewable energy.

Highlands and Islands Enterprise (HIE), along with its local partners - the democratically elected local authorities covering the north of Scotland and the islands; Shetland Islands Council, Orkney Islands Council, Comhairle nan Eilean Siar, The Highland Council and Argyll & Bute Council, make representations to key participants on behalf of industry to influence the way in which regulation of the energy industry is managed in order to ensure the needs and interests of the Highlands and Islands are understood and taken into consideration. HIE also works closely with Scottish Government in relation to regulatory matters.

Together we have a significant interest in supporting our communities, many of which are in the most remote and fragile areas of the UK, to reach their full potential. To that end we have been involved in leading and supporting the growth of the community energy sector in Scotland since 2002, including working direct with communities across the region to support community energy developments. We are hugely concerned that Ofgem has not undertaken a robust impact assessment which considers the impact on community renewable energy projects. The proposals set out in this TCR minded to consultation do not account for the fact that all community owned schemes are connected at distribution and likely to suffer keenly as a result of the proposed changes set out. Returns generated by community energy schemes are reinvested in community facilities, infrastructure and in providing other forms of support to those communities. In many cases the development of such schemes has had a transformational impact on some of the UK's most remote and rural areas, whilst supporting wider government aspirations to support such communities build sustainable and productive futures for themselves.

We have had sight of the Scottish Renewable's response to this consultation, and fully endorse the points it has made.

Our detailed comments on the consultation are below:

Leading Options

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1. **Do you agree that residual charges should be levied on final demand only?**
   No comment

2. **Do you agree with how we have assessed the impacts of the changes we have considered against the principles? If you disagree with our assessment, please provide evidence for your reasoning.**

   In our view, the impact assessment is incomplete with the impacts of this SCR having been assessed in isolation.

   We believe that a wider impact assessment which considers the cumulative impact of recent/current changes to charging arrangements is required. This holistic impact assessment should take into account the recent major changes which have been a precursor to this significant code review – including the outcome of CMP264/265 and P350 transmission losses methodology – and the other potential industry changes which are ongoing and have a significant interface with the TCR – namely the Electricity Network Access Project, BSUoS task force outcomes and the metering and settlement significant code review.

   We would also like to see a wider assessment consider the impact on community owned distributed generation, given the wider societal benefits associated with these projects.

3. **For each user, residual charges are currently based on the costs of the voltage level of the network to which a user is connected and the higher voltage levels of the network, but not from lower voltage levels below the user's connection. At this stage, we are not proposing changes to this aspect of the current arrangements. Are there other approaches that would better meet our TCR principles reducing harmful distortions, fairness and proportionality and practical considerations?**

   No comment

4. **As explained in paragraphs 4.41, 4.43, 4.46, 4.49, 4.80, we think we should prioritise equality within charging segments and equity across all segments. Do you agree that it is fair for all users in the same segment to pay the same charge, and the manner in which we have set the segments? If not, do you know of another approach with available data which would address this issue? Please provide evidence to support your answer.**

   Consumers that have invested in, and may invest in, on-site generation should not be penalised as part of the reforms. We are concerned that the implementation of the TCR is going to increase costs for households and small businesses that have invested in behind-the-meter generation. This is entirely at odds with wider UK and Scottish Government policy which of course encourages exactly this type of investment. The proposed changes will result in higher costs for these users and will act as a disincentive for further investment of this kind. There does seem to be a misalignment between regulatory changes being driven by Ofgem and wider Government policies, including those articulated in the UK Clean Growth and Industrial Strategies and Scottish Government's Energy Strategy.

   We are also extremely concerned about the potential cost increases for vulnerable, low consumption domestic customers. We encourage Ofgem to make special consideration of the need for further market segmentation to account for this group of consumers.

5. **Do you agree that similar customers with and without on-site generation should pay the same residual charges? Should both types of users face the same residual charge for their Line Loss Factor Class (LLFC)?**

   We consider that there needs to be more work done to develop the low consumption consumer market segment. We are very concerned that this market segment is likely to include vulnerable customers that are experiencing fuel poverty. This is a specific issue for the Highlands and Islands given the very high levels of fuel poverty already experienced across the region not least as a result of poor housing quality, much of the area being off the gas grid, and greater weather related challenges.

6. **Do you know of any reasons why the expected consumer benefits from our leading options might not materialise?**

   We are concerned that the proposed changes will result in limited incentive for consumers, businesses and large network users to participate due to the removal of residual charges from 'forward looking' charges. Time of use network charges, triad charges, BSUoS avoidance are all key elements of the overall value proposition for providers of network flexibility. Removing the residual components from these charging elements will subdue participation in flexibility services and undermine efforts under the Electricity Network Access Project to incentivise better use of the networks through forward looking charging signals.

7. **Do you agree that our leading options will be more practical to implement than other options?**

8. **Do you agree with the approaches set out for banding (either LLFC or demanding for agreed capacity)? If not please provide evidence as why different approaches to banding would better facilitate the TCR principles.**

9. **Do you agree that LLFCs are a sensible way to segment residual charges? If not, are there other existing classifications that should be considered in more detail?**

10. **Do you agree with the conclusions we have drawn from our assessment of the following? a) distributional modelling b) the distributional impacts of the options c) our wider system modelling d) how we have interpreted the wider system modelling? Please be specific which assessment you agree/disagree with.**

    The uncertainty and potential negative impact on project economics introduced by this TCR has delayed projects currently in development and could easily stall deployment of future projects altogether.

    We are also very concerned about the potential financial impact on existing generators, particularly those projects connected under ANM schemes and already constrained (and in many cases constrained beyond the level expected at FID). In many cases these projects are community owned with all income being reinvested in community assets, infrastructure and development activities. We are aware that in some cases the loss of existing benefits and introduction of further costs could bankrupt projects.

More generally, we are concerned that the model used does not realistically capture the potential impact on the deployment of renewable energy. Much of the renewable energy industry is currently struggling to find its place in the market given the lack of strong policy support from Government. Developing and funding 'subsidy free' renewable energy projects is high risk and low margin. These changes not only undermine the potential value from existing and planned deployments but also increase the overall perception of regulatory risk within the UK market. This increased perception of regulatory risk will increase the cost of capital for energy developments in the UK. This in turn will result in removal of value from consumers, which is passed to lenders – increasing costs for electricity customers.

In the face of higher costs, lower revenues and increased risk, renewable energy deployment will reduce. Therefore, we disagree with the analysis assumption that deployment will remain unaffected by the outcome of the TCR. Further, we do not consider the use of the 'Steady Progression' FES scenario as a representative baseline for the analysis as it does not meet any of the UK government's climate change targets.

<u>**Embedded benefits**</u>

11. **Do you agree with our proposed approach to the reform of the remaining non-locational Embedded Benefits?**

    The current temporary solution in place to ensure a level playing field for small generators is delivered by Ofgem through the Small Generator Discount. The expiry date of this arrangement has been extended four times, with the next expiry date set for March 2021. The most recent extension pre-judges the outcome of the TCR, and there is inadequate information to suggest that all significant distortions will be resolved by March 2021 in any case.

    Ultimately, a long-term solution would allow investors to have the confidence and certainty to push ahead with renewable projects. Further, it would mitigate the financial constraints imposed on investors due to uncertainty, which in turn, would facilitate the deployment of future renewable projects.

12. **Do you agree with our proposal not to address any other remaining Embedded Benefits at this stage? Which of the embedded benefits do you think should be removed as outlined in xx? Please state your reasoning and provide evidence to support your answer.**

    No comment.

13. **Are there any reasons we have not included that mean that the remaining Embedded Benefits should be maintained?**

    No comment.

<u>**Transitional arrangements**</u>

14. **Do you agree with our proposed approach to transitional arrangements for reforms to: a) transmission and distribution residual charges b) non-locational Embedded Benefits? Please provide evidence to indicate why different arrangements would be more appropriate.**

No comment.

<u>Ofgem 'minded-to' position</u>

15. **Do you agree with our minded to decision set out? If not please state your reasoning and provide evidence to support your answer.**

We do not agree with the minded to decision.

We consider that the proposals set out within the consultation are pulling the industry in the opposite direction to wider government policy. The resulting reduction in renewable energy deployment undermines deployment of further renewable energy, achievement of climate change targets, and the aims of the Clean Growth and Industrial strategies. We are also of the view that Ofgem's 'minded to' position is in direct opposition to the Electricity Network Access Project significant code review which is seeking to incentivise better use of the networks through better charging arrangements.

The removal of the Transmission Generator Residual component of the TNUoS tariff will further harm the deployment of renewable energy deployment. We are particularly concerned about the impact on developments located in the north of Scotland as these generators are most exposed to wider zonal TNUoS tariffs. Increases to these tariffs will have a significant impact on these schemes – pre-existing and planned.

The removal of the residual component will draw into sharp focus the extreme differences between treatment of generators in Scotland compared to the remainder of GB. If removed, generators located in Scotland will continue to be substantially liable for wider zonal TNUoS, whilst generators in the remainder of GB will not. According to National Grid's current TNUoS forecast, the average wider zonal tariff for intermittent generation in Scotland will be £26.38/kW by 2023/24, whilst the average tariff across all zones in England and Wales will be £-0.37/kW. This extreme disparity between the charging realities between Scotland and the remainder of GB is unacceptable and indicates a serious failing in the current methodology for calculating TNUoS charges.

Further, we are concerned that these fresh uncertainties and risks are coming at a time when Ofgem is seeking additional assurances and project commitment before committing to spend on island transmission links. Ofgem's current consultation on the Orkney needs case makes this very clear, and we would expect that the forthcoming consultations for both Shetland the Western Isles will follow suit. This compounds the challenges already faced by developers of island projects, which are some of the most efficient onshore projects and many of which are being developed by local businesses or communities.

16. **For our preferred option do you think there are practical consideration or difficulties that we have not taken account of? Please provide evidence to support your answer.**

No comment.

We hope you find these comments helpful, and we look forward to seeing the results of the consultation in due course.

Yours sincerely

Elaine Hanton

Elaine Hanton
Head of Energy: Emerging Technologies and Regulation

In partnership with:-
Shetland Islands Council
Orkney Islands Council
Comhairle nan Eilean Siar
The Highland Council
Argyll & Bute Council