

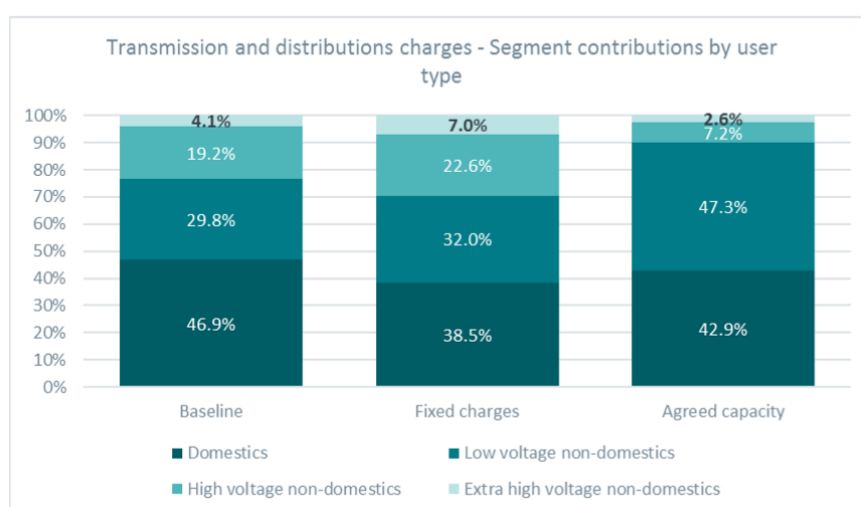
Submission to Ofgem's consultation on the Targeted Charging Review 'Minded To' Decision and Draft Impact Assessment

Date: 4 February 2019

To: TCR@Ofgem.gov.uk

Manufacturers welcome the chance to respond to Ofgem's proposals however we have a number of overarching concerns about the approach being taken:

- It is clear from graph below that costs for EHV/Transmission- and HV-connected users would increase under the Fixed Charges approach. Our estimates based on other figures Ofgem has provided put the increase across these groups at £100m and £119m per year respectively. Meanwhile, the annual benefits experienced by the same groups as a result of TCR look much smaller (perhaps £20m/year at most¹). We understand that there may be further savings for industry, and particularly those sites able to actively manage their electricity consumption, as a result of the Access & Forward-Looking Charges (AFLC) review. It is frustrating therefore not to know more about these or have greater guarantee that they will materialise. **We believe the two reviews should be carried out in conjunction and their impacts assessed together. It is also inappropriate to make any decision on the TCR while the Capacity Market, which is vital to realising its stated benefits, is in chaos.**



Source: TCR consultation paper, figure 5

¹ Estimate based on dividing consumer cost savings by 17 years and then by user groups' share of consumption

- Despite the numbers quoted above, our site level analysis shows a considerable array of different charges across regions, types of site and charging methodology. This and the fact that Ofgem has had to revise the advice it provides on calculating site level impacts multiple times during the consultation period **leaves us very uncertain about any of the impact calculations Ofgem or manufacturers have done. Ofgem has also failed to provide any high level assumptions about the degree of redistribution expected within each group of consumers.** In this situation we do not believe we can offer analysis of the options presented with any confidence.
- Ofgem's approach appears to be pulling in a completely different direction to that of the Government energy policy. Government is trying to encourage flexibility through demand-side response (DSR) and has long backed Combined Heat and Power (CHP), which is also mandated in some cases through environmental permits. It also has a stated aim to try and achieve the lowest electricity prices in Europe for all consumers. Ofgem on the other hand is **pursuing a policy which its own analysis says will remove a sizeable portion of CHP from the system, failed to model the impact on DSR at all, and appears totally unconcerned about its proposals increasing costs to an unspecified degree for parts of industry.** This kind of contradiction and changeable policy environment is rapidly undermining investor confidence.

Ofgem must conduct another round of impact assessment and consultation taking into account all of the above points and adjust its timescale for TCR accordingly.

Response to questions

1. Do you agree that residual charges should be levied on final demand only?

Levying on end consumers only would appear to make sense in terms of simplification and potentially increases clarity given suppliers will pass on any costs they face to consumers anyway. However, if it is complicated to entirely separate out demand and supply on the EHV network, it might be simpler to levy the charge on some elements of supply too in that context.

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.

While Ofgem's decisionmaking process is largely qualitative, for industry it is essential to understand the cost implications of what is being proposed.

As discussed above, we have been disappointed at the quality of the information provided on this front. Ofgem has had to clarify a number of points during the consultation period, with the latest update coming less than two weeks before the closing date. Even then, there are considerable uncertainties in the figures given.

The largest of these is in the fixed charge for EDCM, where Ofgem has simply no idea of the scale by which charges might increase when generation is removed from the charging base.

It is impossible for industry to comment on charges that could, for some elements, be four times larger than set out. It is also unclear how sites with multiple MPANs will be treated in the final outcome now Ofgem is more aware of the issue and whether the deemed capacities might change for domestic consumers under the Agreed Capacity approach, both of which will have an impact on eventual charges.

This is all the more disappointing given we repeatedly asked Ofgem to share the assumptions being used in its impact assessment and findings as it went along, which would have avoided this situation. We had also been promised a study into what fairness meant for large users, which we had welcomed as an opportunity to discuss issues around competitiveness and the appropriate spread of charging between different types of consumer. The final study on this is a considerable disappointment, simply setting out a list of factors that might determine large users' responses to higher charges.

On top of this, are the uncertainties around the AFLC review, which will have a material impact on the scale of the residual charges as well as looking at the signals that incentivise load management and potentially overlapping with the TCR in other areas such as the EDCM/CDCM boundary and the way capacity is agreed and used.

Given the degree of uncertainty with which we are now presented, Ofgem must commit to another round of impact assessment and consultation, ideally consolidating both the TCR and AFLC review. As discussed later, we are not convinced of the case for rushing the TCR decision and implementation and believe it is vital that the review is given the time needed to ensure a robust outcome.

- 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?***

We would question whether this is really the case when EDCM consumers are all treated the same way regardless of the voltage of their connection and there is uncertainty over the boundary between EDCM and CDCM charges, meaning the former could in fact be subsidising the latter.

However, at the most basic level, it would seem to make sense that distribution-connected users contribute towards transmission costs as they are not isolated from the transmission grid and that transmission-connected users are not expected to pay for the distribution grid.

- 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.***

We would prefer an approach that looked at the end impact on bills of the different proposals and attempted to put the UK in a stronger competitive position. Analysis by UK Steel, one part of EEF, has found domestic steelmakers are already paying 50%, or £22/megawatt hour, more for their electricity than counterparts in Germany and 110%, or £35/megawatt hour, more than French steel plants². Any increase at all in these kinds of disparities would be very detrimental to more energy intensive industries. It is notable in this context that the exemptions from decarbonisation subsidies offered to energy intensive industries only cost domestic consumers a few pounds a year.

That aside, we agree with the principle under the fixed charges scenario that categories of users should be charged on the basis of their net consumption.

It would be hard as a trade association to comment on the way charges are spread within groups as there are likely to be winners and losers under any approach used.

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 believe there should be a recognition at some point in the system for the service DSR and onsite generation can contribute to the electricity system overall. It is also worth noting that onsite generation is not an optional extra for industrial sites with combined heat and power or that generate electricity from waste gases. They would not be operating for long if these systems were not operational and/or are likely to be in breach of environmental permits.

This recognition might not need to be through residual charges, but industrial electricity consumers that have managed their demand on the grid previously need reassurance that the changes will not have a significant negative overall impact on their electricity costs and clarity on what reward there will be for these activities in future.

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

The approach used seems to put considerable faith in the Capacity Market which, quite apart from its current problems, has not been rigorously challenged so far. It also might depend on the measures put in place under the AFLC regime, which could impact TCR outcomes, and other government policies aimed at incentivising smart flexible energy use. We would also note that the modelling does not seem to take into account DSR, which avoids the need for new generation – and associated costs – altogether. This is extremely disappointing for energy intensive industries, many of which are very active load managers.

² UK Steel, 2018, The Energy Price Scandal: A Fair Power Deal For UK Steel
(<https://www.eef.org.uk/~media/273dcac7c6824ec090b75a86b9172e8c.pdf>)

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

They do appear relatively straightforward on paper. However, as noted earlier, several questions and uncertainties have already arisen, for instance around the level at which the charges are calculated (site level for EDCM and MPAN level – or it now appears connection points level – for CDCM sites).

Industrial sites often have varying numbers of MPANs (up to ten on one steel site) for historical reasons and sometimes shared MPANs. Charging on this basis is likely to have a significant distortive effect so we would ask that a way is found of aggregating MPANs to effectively come up with a site-level charge for CDCM as well.

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

Again, it is difficult for trade associations to comment on this area as they will have a mixture of winners and losers in their membership, but if boundary effects within some user categories are very considerable there might be a case for further divisions. The use of LLFCs could potentially lock in a system that over time becomes unfit for its original purpose or cause upset if LLFCs need to be changed for reasons unrelated to TCR.

In the case of Agreed Capacity, there should be potential for reassessment of the option if further investigation proves that current assumptions about domestic consumers are wrong, potentially impacting the system as a whole.

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?

From what we've seen of members' initial calculations, the assessment of impact on sample consumers may not be representative of many within the industrial segment. It is also worth noting that some sizeable inequalities are seen close to voltage level boundaries. For some

assets, the potential increase may put their viability at risk. It is unclear whether the modelling accounts for the potential disconnection of these assets.

As noted previously, we are also concerned at the degree of uncertainty still inherent in the figures, the lack of consideration of DSR in the wider system modelling or – potentially more significantly – the impacts of the AFLC review. This must be addressed through further impact assessment and consultation.

Our own rough calculations suggesting an average price increase for EHV and Transmission-connected customers of £5/MWh and of £2/MWh for HV customers under the Fixed Charges proposal are very worrying. That is a significant rise and, if that is the average figure, some sites and companies will be far worse off. Although Agreed Capacity looks like a better option on paper from that perspective, site-level evidence suggests there will also be a considerable number of companies worse off under that approach, casting further doubt on the current modelling work.

The predicted savings from TCR appear relatively marginal for energy intensive industries when set against the potential costs.

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

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.

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

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.

We believe the changes should be implemented at the same time as the outcome of the AFLC review, which we note may still be delayed. The two reforms are interlinked and introducing one before the other and in a phased manner will add to the complexity. This would also allow more time to consult again on the TCR and for the Capacity Market to be reinstated. We are not convinced of the case for rushing implementation of the TCR on the basis of consumer cost savings when elsewhere in the consultation document Ofgem says that these are very uncertain and it is better to focus on system cost savings.

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

As discussed above, we have considerable doubts about the approach being followed and would like a fuller assessment to be done alongside that of the AFLC review.

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.

We note the uncertainties that have arisen around MPANs, connection points, etc. and would urge Ofgem to find a way to ensure that this does not create inequality between similar sites for purely historical reasons. One option would be to allow sites to consolidate MPANs. As discussed above, there are also a number of issues being considered under the AFLC review that might need to be reflected here, plus the uncertainties around the Capacity Market.

FOR FURTHER INFORMATION CONTACT:

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