

TCR: MINDED TO DECISION: Flexibility First Forum, consultation response

Introduction to the Flexibility First Forum

The Flexibility First Forum is an affiliation of organisations who span the energy flexibility services supply chain. From manufacturers to trade associations, to suppliers to generators, the organisations have come together to promote the value and benefit of flexibility to the energy system and to customers. For a flexible energy system to become a reality, network company incentives need to improve so that network operators are rewarded for effective grid utilisation and procuring flexibility services as a first measure.

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

The Flexibility First Forum think that in principle, all final demand users should pay for the network's upkeep on the basis of an effective substitute being found for the proposed fixed or capacity charging mechanisms.

Given that changes to residual charges alongside other reform options (removal of the TGR and BSUoS reform) may well generate a windfall for some participants on the system, Ofgem, should monitor how costs are filtered through the energy system so that these savings are felt by consumers.

We would stress that there are significant changes proposed in network charging that, especially in this case, go against the policy direction outlined by Government in its Smart Systems and Flexibility Plan. We continue to ask for consistency on implementation and direction of network charging reform so that inconsistent investment signals are not given through piecemeal reform and implementation.

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.

The Flexibility First Forum have concerns about the way fairness and the reduction of harmful distortions has been assessed.

Harmful distortions - impact on flexibility services

We do not believe the impact assessment has properly considered the distorting impact that flattening the residual charges will have on flexibility and the benefits that flexibility could bring to the system.

Paragraph 3.2 of the 'minded to' decision outlines that Ofgem's principal objective is to protect the interests of existing and future energy consumers. Flexibility is key to securing the least cost-pathway to decarbonisation and studies by Imperial College London have shown that customers could benefit by the sum of £6.9bn a year if regulation and policy enable the full benefits of residential flexibility onto the energy system. These savings are

achieved by reducing the investment required in network infrastructure, and from using cheaper renewables like wind and solar instead of more expensive low carbon generation.

The changes proposed under the TCR 'minded to' decision do not take into consideration how these will dampen the advancements in the flexibility services market. While some have suggested that action in the Access and Forward Looking Charges consultation could compensate for the value lost through this change, the assessment carried out in this decision was not made jointly with SCR analysis.

Currently, the forward-looking aspects of network charges are not sufficiently cost-reflective and networks are not sufficiently encouraged to pursue flexible solutions. The impact assessment does not take due consideration of the combined impact of the TCR and the SCRs on the potential outcomes for the industry and these issues cannot be separated, particularly when the reviews are happening in parallel.

The TCR minded to proposals should not be pursued until the changes in the Access and Forward Looking Charges are clear so the full impact of change can be assessed.

Fairness - encouraging more electricity usage and penalising early adopters

By moving to a fixed or capacity based charge, this will reward those who use more electricity rather than less at peak times. This is a harmful distortion as it could profligate energy consumption and increase carbon emissions through increased fuel consumption.

It is concerning too that those homes and customers who have sought to effectively manage and reduce their electricity consumption and help decarbonise the grid will be penalised with higher bills as a result of these proposals.

The proposed bandings and charges for different types of domestic customer under agreed capacity users is unfair and sets a disincentive for the adoption of storage and electric vehicles. We do not believe the 10% figure for domestic electric vehicles and heat pumps is realistic given the government's 2040 EV targets and we would suggest in general, domestic customers will be moving towards electric vehicles as the norm in the coming years. We would suggest these bandings are not forward looking and would not be fit for purpose.

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?

Should the correct pricing signals be implemented, a smart, flexible energy system will see multidirectional power flows become business as usual. At this stage, we would encourage Ofgem to conduct analysis on the whole system to assess whether residual charges should be paid by all consumers.

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.

By moving to fixed or capacity based charges, reductions could be gained for those who use more electricity rather than less. It is also a disincentive for users to install on-site generation and storage, and will penalise those that have. This is a harmful distortion as it could lead to profligate energy consumption and increases carbon emissions.

Those homes and customers who have sought to effectively manage and reduce their electricity consumption and help decarbonise the grid will be penalised with higher bills as a result of this change. This is a disincentive to the adoption of management technologies, electric vehicles and renewable energy. In essence, it penalises those who have spent money on becoming more efficient.

The proposed bandings and charges for different types of domestic customer under agreed capacity users is unfair and sets a disincentive for the adoption of storage and electric vehicles. We do not believe the 10% figure for domestic electric vehicles and heat pumps is realistic given the government's 2040 EV targets. We would suggest in general, domestic customers will be moving towards electric vehicles as the norm in the coming years and so should not be categorised as distinct. We would suggest these banding are not future-proof and would not be fit for purpose.

It is concerning that customers who are on tariffs like Economy 7 that help ease congestion on the grid, are seemingly penalised for positive behaviour. Because of the detrimental distortions for domestic customers outlined in question 2 and the damaging impact these charges would have on residential flexibility, we would recommend that domestic users are not included in the changes proposed for residual charges until compensatory price signals that do encourage the behaviour change are introduced. This would enable Ofgem to address current distortions, while reducing the negative impact on 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)?

There will be a detrimental impact on the growth of local and domestic flexibility as a result of reform to residual charges. The government and Ofgem have previously indicated their support of flexibility services and companies like those in the Flexibility First Forum have invested heavily in the technology required so that customers who want to support balancing the grid either through storage or onsite generation can do so.

It is concerning too that those domestic customers who have sought to effectively manage and reduce their electricity consumption and help decarbonise the grid (through domestic DSR technologies and onsite generation) will be penalised with higher bills as a result of this change.

Domestic customers who have been forward-looking in their decision to install on-site generation and storage should not be penalised for demonstrating behaviours the government has previously encouraged. Forward-looking domestic customers should not be more negatively affected by price changes than those who have not engaged with the market.

Regarding LLFC, while we understand the use of LLFC categories for ease of classification, we would note that LLFC was not designed with this policy area in mind. It should be reviewed in the future to ensure it's fit for purpose.

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

As recognised in Ofgem's own impact assessment, there are scenarios in which forward looking domestic customers, like those who have ownership of EVs and those who are on tariffs that help ease congestion on the grid, like Economy 7, will not see customer benefit from these changes.

Ofgem's modelling has explicitly ignored the network impacts which could cause a significant deviation in consumer benefits as a result of removing the incentives for a smart flexible network - the Imperial College report "Blueprint for a post Carbon Society" shows the whole system benefit of residential flexibility could be up to £6.9billion. Therefore, the £8 customer benefit suggested by Ofgem is not being considered against the negative impact this could have on the flexibility market.

There will be a significant impact on the willingness to invest in the provision of local flexibility resulting from residual reform, and it is important that Ofgem understands how this regulatory development will negatively impact the investment environment for flexibility projects. Ofgem has said it does not consider that the TCR 'minded to' proposal poses increased risk to the industry (and that there is therefore no increase to investment risk/capital cost) - however, the Flexibility First Forum would outline that the outcome of the TCR conflicts with BEIS' policy direction on flexibility and, concluding ahead of the forward-looking charges review, provides no confidence that this will be rectified.

Ofgem are proposing to implement changes in a piecemeal fashion in a way that will reduce investor returns. This is poor regulatory practice and will increase the cost of capital for future investment.

Ofgem, at a talk given about the TCR, stated that the TCR is not considering the generation mix or the carbon intensity of the generation in its minded-to position. The impact of the TCR

on the UK's system flexibility and ability to reduce carbon in energy generation is not being considered in this minded to position.

As noted above, Ofgem's impact assessment notes reductions in cost that appear to be either overstated or unreliable, increases in balancing cost impacts (via changes to BSUoS) and the value of local flexibility are missing from system costs. We believe this is ground for Ofgem to consider delayed implementation.

The Flexibility First Forum would advocate a more holistic charging review and that Ofgem should not reform residual charges without aligning compensatory changes for flexibility services.

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

We do not believe practicality should be a main driver in ensuring pricing signals support an energy system that is fit for the future.

The Flexibility First Forum would urge Ofgem to consider that the practicality of implementation on domestic customers in the context of market-wide Half Hourly settlement, price cap and other domestic market reform may not be as simple as modelled.

A focus on practicality at this stage may appear to be putting off the inevitable and desperately needed back of house system updates. We believe this are grounds for Ofgem to consider the impact of the proposals if HH settlement for all users was in place.

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

Domestic customers who have been forward looking in their decision to install on-site generation and storage should not be penalised for demonstrating behaviours the government has previously encouraged. Forward-looking domestic customers should not be more negatively affected by price changes than those who have not engaged with the market and have sought to reduce their consumption.

Regarding LLFC, while we understand the use of LLFC categories for ease of classification, we would note that LLFC was not designed for this policy area in mind. It should be reviewed in the future to ensure it is fit for purpose.

If capacity-based allocation was adopted, we have concerns about the suggested bandings 4KVA, 6KVA, and 8KVA for domestic customers. Given the Government EV targets and the greater uptake of electrified devices and heat pumps, we do not think this assessment is fit for purpose or future looking. With these charges, we believe the majority of domestic customers could end up paying more, or that the higher charges could act as a disincentive

for EV and heat pump uptake. This appears in stark contrast to the headline government targets set to fight climate change.

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?

Regarding LLFC, while we understand the use of LLFC categories for ease of classification, we would note that LLFC was not designed for this policy area in mind. It should be reviewed in the future to ensure it is fit for purpose. We particularly think this is not fit for purpose for the Economy 7 classification, Economy 7 customers are often lower income households and have helped ease congestion on the grid, their higher banding would see them seemingly penalised for positive behaviour.

Would using the LLFC be the choice route if all users had a HH settlement meter? If not, then this route is obviously not suitable for the future when HH settlement is implemented.

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.**

A primary role of the impact assessment should be to examine, provide evidence to, and determine the value of net demand reduction on the long-term costs of the network. Ofgem's approach appears to instead focus on a few smaller elements of the charging regime, without analysing and revealing that value of residential flexibility.

We don't disagree that business models based on a known defect shouldn't be protected, but by considering a minded-to position in isolation of the strong signals needed for the smart, flexible system that BEIS and Ofgem have been working towards, investor confidence in a smart, flexible grid is not maintained. In addition, ignoring network/infrastructure costs in the modelling is a significant shortfall - the impact assessment ignores the impact on the likelihood and efficiency of a smart grid rollout and therefore the conclusions have limited value and are poor evidence for this change.

Regarding system modelling for residual reform, there is likely to be a significant impact on the willingness to invest in the provision of local flexibility resulting from the proposed residual reform. In the modelling, we are concerned that this understated the value of local flexibility. The localised nature of some types of flexibility, such as that situated behind-the-meter, means that these may well be especially well-suited to providing services to avoid unnecessary network reinforcement.

Renewable build will be affected by the proposed changes. The assessment assumes that this will not be the case. This assumption is particularly unrealistic given the current government policy outlook for renewable energy.

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.

Ofgem should recognise the detrimental impact the reform to residual charges will have on the growth of local flexibility. Greater flexibility will be required on the energy system if energy is going to be provided to customers at least cost.

Ofgem and the Government should ensure market arrangements allow flexibility providers to realise the full value they provide. Cost-reflective, forward-looking charges are part of this, as are reforms under RII02 and particularly the next Electricity Distribution Price Control. To avoid the risk of stalling the development of local flexibility, these residual reforms should be implemented alongside the other changes necessary.

By providing clarity on where the Government and Ofgem see strong price signals for flexibility emerging, this will avoid unnecessary instability in network charges and improve investor confidence.

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

While we agree that the cost of existing grid should be collected fairly, the blanket fixed cost on residual charges takes reform in the wrong direction, particularly when not aligned to change within the Access and Forward Looking Charges SCR. The proposal undermines the flexibility market and will have a detrimental impact on the flexibility industry. For that reason, we do not support the minded to decision.

The Government and Ofgem have made clear that flexibility is part of future energy system. If this is a legitimate ambition, before these changes should happen, clarity should be given on how Ofgem's intends to provide price signals strong enough to support the flexibility market. Reform should not take place before clarity is provided on how the Government and Regulator intend to introduce price signals that sustain flexibility services.

We understand that the motivation for this change is driven by larger users' ability to shift their demand so they don't pay residual charges. Ofgem's own impact assessment demonstrates that domestic adopters of balancing technologies and storage have minimal impact on the overall amount recovered through residual charges, yet the changes proposed by Ofgem would see customers demonstrating positive behaviour for the energy system (in terms of reducing congestion and contributing to the decarbonisation effort) economically punished by these reforms. We would recommend that any changes to residual charges should not take place for domestic customers until the market signals are in place so they are appropriately rewarded for helping balance the system through energy flexibility.

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

The impact analysis piece isn't accurate without reforms to the forward-looking access charges included. The impact assessment highlights HHS reform and the consumer benefit of load shifting as a positive, but ignores the dampening effect this proposal will have on that behaviour. In addition, ignoring network impacts further limits the usefulness of the analysis, especially when comparing the potential benefits of reform (£0.8 - £3.2bn cumulatively to 2040) with the Imperial College London "Blueprint for a Post Carbon Society" report (£6.9bn per year)

We urge Ofgem to ensure that TCR decisions are not made in isolation but with a wider market context and other existing reform.

Ofgem acknowledged during a TCR talk that this work is being carried out in isolation to the UK's decarbonisation goals. At the talk given by Ofgem, it was stated that the TCR does not look at generation mix and does take into consideration carbon intensity in this piece of work. The narrow focus of the TCR will impact on the wider UK goals, its implementation will have a negative impact on the flexibility that the Government desires and the country needs.

Not caring about the generation mix is not only an alarming statement given the UK's aim to decarbonise and help in the fight against climate change it also conveys a mixed desire to protect those struggling with the costs of energy given that renewables and storage will be and, in some cases, already are a cheaper source of generation – both financially and environmentally.

This submission has been sent on behalf of the Flexibility First Forum and has the support of the following organisations:

The ADE
Caplor
Centrica
Chameleon
Eco2 Solar
Eneropp
geo
Lux Nova Partners
Moixa
Octopus Energy
Open Energi
OVO
PassivSystems
PivotPower
REA
RenewableUK
Solo Energy