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4 February 2019

**EDF Energy response to Ofgem's Targeted Charging Review (TCR) consultation: minded to decision and draft impact assessment**

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply and services to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users

**Summary**

EDF Energy welcome the opportunity to respond to this consultation. EDF Energy agrees that the current network charging arrangements are not fair for consumers and are creating market distortions leading to higher costs for consumers. We agree that reform is necessary. We advocated urgent and targeted reform on embedded benefits through our CUSC modification CMP265, which has now been implemented, but acknowledged that, with more time, further reforms were necessary to deliver fairer allocation of network costs.

**Network residual charges**

We support reform to the demand residual either to a fixed or capacity basis. This will help to ensure that all consumers pay a fair share of the network costs by limiting charge avoidance through the installation of behind-the-meter generation. However, Ofgem's currently proposed implementation approach for the capacity option is likely to materially increase implementation costs and should not be adopted (deeming capacity based on development of new usage profiles). We recommend that simple existing industry data is used either for the fixed or capacity option and propose an alternative more practical solution for an agreed capacity solution if this were to be adopted.

We recognise that under either option there are material distributional impacts between and within customer groups (including customers in vulnerable situations and energy intensive users). It will be important through the detailed implementation that the distributional effects are considered carefully and where possible balanced between customer groups.

We request a delay in implementation by one year from 2021 to 2022 to reflect commercial contracts in place with customers and the time required to ensure IT system updates are completed.

**Other embedded benefits**

Ofgem propose three further reforms: setting the Transmission Generation Residual to zero, removing BSUoS embedded benefits and applying BSUoS to smaller generators.

Setting the TGR to zero is not something larger generators had considered even legally possible due to the cap in the European Regulation EC838/2010. It was only late in 2017 that it became clearer that this was not Ofgem's view. Ofgem's revised view was subsequently unsuccessfully challenged by EDF Energy and SSE to the Competition and Markets Authority in 2018. During the CMA process Ofgem sought to

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provide assurance noting that future changes impacting GB generators would only *happen over a reasonable period of time* and that Ofgem had *no desire to maximise charges for generators*.

Ofgem's current proposal to implement reform from April 2020 has material consequences for GB generators in the short term or indeed in the longer-term for Renewable generators. As we have previously set out, significant volumes of generation have, in good faith, entered into Capacity Market T-4 contracts through to 2022. Implementation timescales for this reform need to be extended well beyond Ofgem's current proposal. We also note that, without other changes to network charging arrangements, TGR will be forced negative again by around 2022/23 undermining Ofgem's intent.

We are also concerned about the relative competitiveness between GB and mainland Europe generators that in general are not exposed to transmission charges. In this context, we believe that reforms are needed to TNUoS charges to address this distortion. We are developing proposals that we believe addresses this issue while at the same time delivering a sustainable approach to Ofgem's proposal to set TGR=0. A later implementation date for reform of the Transmission Generation Residual would enable all these issues to be considered in full. Given this we recommend implementation of TGR reform no earlier than 2023.

Finally, we note that while BSUoS embedded reform has been under consideration for some time, applying BSUoS charges to smaller generators is a new idea and a change of approach by Ofgem. EDF Energy had previously raised CMP308 which proposes to levy BSUoS charges only on Demand. This is because we believe that BSUoS is a cost recovery charge. We consider that this approach is preferable rather than introducing a new charge on smaller generators. However, if this is not acceptable then we support a reasonable implementation period for BSUoS reform.

We would welcome a meeting with you to discuss our thinking in these areas and our TCR response generally.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 07967 151 272, or me. I confirm that this letter and its attachment may be published on the Ofgem website.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Angela Hepworth".

**Angela Hepworth**  
**Corporate Policy and Regulation Director**

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

EDF Energy agree in principle that residual charges should be levied on final demand only. Residual charges have no pricing signals and it seems more effective to pass them directly to final demand. If instead the residual costs were recovered in part from generators then they will look to pass through these costs to customers, e.g. through the Capacity Market, which is likely to be less efficient.

**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.**

EDF Energy supports the assessment that has been carried on the proposed Demand Residual reform. In particular the range of work done to assess the impact reform will have on different user groups and the balanced approach to the principles.

We have raised concerns previously that delivery of the most optimal solution could be very expensive to implement through additional IT costs for network companies and suppliers – this would be likely to undermine the overall consumer benefits.

We have some concern over the deeming for Agreed Capacity option which we address in Question 7 and 8.

**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 agree with Ofgem's assessment that there are neither merit to, nor compelling reasons for, changes to the recovery of residual revenues from users based on their voltage of connection. Changing it would create further distribution effects without any clear benefit.

- 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.**

EDF Energy agree that there should be equality within charging segments so that all similar types of customers (not specific to metering configuration such as unrestricted and Economy 7) connected at the same voltage are charged the same residual value.

Ultimately, the residual charge is trying to recover a sunk cost from customers who have access to a secure and reliable network. The voltage level of connection is an appropriate way to charge the same contribution to those customers.

We are fully aware that with such significant reform certain customer groups could be faced with significantly different costs. Ofgem need to proactively monitor any large impacts and consider mitigating measures such as transitional arrangements as the detail of the implementation is confirmed.

- 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)?**

In response to Question 4 we confirm that fairness across a segment is important. This also therefore applies to the type of activity at any given site.

We therefore believe it wholly appropriate that all users with or without on-site generation should be exposed to the same charge.

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

EDF Energy believe that the expected consumer benefits arising from the reforms relating to the demand residual should broadly materialise so long as the implementation of any reform is simple. We would expect consumer benefits to not fully materialise should the delivery of an option require extensive IT and ongoing process costs. i.e. through non-standard industry segmentations.

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

EDF Energy agrees that the Fixed and Agreed Capacity (linked to standard industry data) options are more practical to implement against the other options Ofgem short-listed in the previous consultation.

Fixed recovery is a simple concept and ensures residual costs cannot be reduced through any behavioural activity.

Agreed Capacity could still allow some limited form of cost avoidance to take place, but it remains an effective way to recover residual costs if implemented using standard industry data. We would not support this option if implemented using the deemed capacity approach, as Ofgem are currently proposing. We provided further detail in our response to Question 8.

**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.**

We agree with the approach set out for banding using LLFC but have reservations on deeming customers for the agreed capacity option as set out below and that a LLFC approach would be far more cost-effective implementation.

**LLFC**

This is an existing banding widely used and understood in distribution charging.

It aligns closely to the TCR principles. It is practical and proportional to implement; it removes harmful distortions without creating any new ones and ensures fairness amongst users connected at the same voltage level.

**Agreed Capacity**

We broadly support the approach to using agreed capacity for non-deemed customers. However, we note that this banding approach still allows some incentive to avoid costs. Customers with on-site baseload generators or batteries are still able to generate and thus reduce their agreed capacity levels.

For those customers who require an agreed capacity value to be deemed we have serious concern that the proposed solution appears to link this to a usage profile (e.g. user of an Electric Vehicle, Heat Pump, etc.). This information is not currently available and use of any non-standard industry data involves new processes to be set up which can be cumbersome and costly for both network companies and suppliers. If this solution were adopted this would add several million pounds of implementation costs which would reduce the consumer benefits identified.

We propose that should the agreed capacity approach be chosen, that deemed customers be linked to LLFC and non-deemed customers be linked to agreements they have in place with their distribution company.

This hybrid approach of using agreed capacity where available and LLFC to deem capacity for smaller users is far more practical to implement and aligns more closely with the practical and proportional 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?**

EDF Energy agrees that it is sensible to segment residual charges by LLFCs. The effectiveness of the LLFC methodology works on the basis that higher LLFCs reflect a certain level of network usage i.e., a higher LLFC indicates a longer cable and hence higher fixed costs. It is EDF Energy's view that all similar types of customers connected at a given voltage level (not specific to metering configuration such as unrestricted and Economy 7) should bear the same residual costs for operating on this network.

**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.**

We believe that the conclusions drawn from the assessment on the demand residual recovery appears sound. Again, we note that an increase cost for poor implementation will likely impact overall consumer benefits.

For other embedded benefits please see questions below.

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

EDF Energy agrees that the issue of remaining non-locational Embedded Benefits merits reform.

Ofgem propose three further reforms: setting the Transmission Generation Residual to zero, removing BSUoS embedded benefits and applying BSUoS to smaller generators.

Setting the TGR to zero is not something larger generators had considered legally possible due to the cap in the European Regulation EC838/2010. Therefore, this should be implemented no earlier than 2023.

It was only late in 2017 that it became clearer that this was not Ofgem's view. Ofgem's revised view was subsequently unsuccessfully challenged by EDF Energy and SSE to the Competition and Markets Authority in 2018. Through the CMA process Ofgem sought to provide assurance noting that future

changes impacting GB generators would only happen “over a reasonable period of time” and that Ofgem had “no desire to maximise charges for generators”.

This proposal has material consequences for GB generators particularly in the short term. As we have previously set out, significant volumes of generation have, in good faith, entered into Capacity Market T-4 contracts through to 2022. Therefore, this reform should not be implemented before 2023.

Additionally, Ofgem’s attempt to remove the negative adjustment through setting TGR to zero is not enduring and by as early as 2022/23 other measures (e.g. reducing the error margin in the EC838/2010 calculation or moving the reference node) would be required to satisfy Ofgem’s policy intent.

This reform also compounds the market distortions between GB and mainland European generators that in general are not exposed to transmission charges. Equally with Ofgem’s policy proposal to levy TNUoS charges on smaller generators (through Review of access and forward-looking charges) and distortion between larger and smaller GB generators will be addressed without the need for this reform.

We are therefore developing proposals that we believe addresses this issue while at the same time delivering a sustainable approach to Ofgem’s proposal to set TGR=0.

With relation to BSUoS embedded reform, this has been under consideration for some time but applying BSUoS charges to smaller generators is a new idea and a change of approach by Ofgem and not something smaller generators could have reasonably taken into consideration in investment decisions.

Likewise, there should be a reasonable implementation period for these reforms.

Timing of implementation plays an important role. EDF Energy’s has raised CMP308 modification that seeks to move BSUoS charges to demand only. If Ofgem agrees that final demand should recover all BSUoS charges, then embedded generators need to have this signal in advance of BSUoS reform under the TCR. Should Ofgem disagree with the modification, then we re-iterate, a reasonable implementation period would be required.

**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? Please state your reasoning and provide evidence to support your answer.**

EDF agrees with the proposal and not seek to address any of the other of remaining embedded benefits, such as RCRC, AAHEDC at this time. This is because they are of relatively low value currently and unlikely to cause any market distortions, however, this may need to be considered further in the future.

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

No. EDF Energy suggests that given the relatively low value of the remaining embedded benefits there are higher priority areas that Ofgem and industry could concentrate on.

**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.**

EDF Energy does not agree with the proposed 2020 or 2021 implementation dates for the non-locational embedded benefits reforms. These are material reforms most of which are new initiatives impacting on commercial decisions made by generation investors. Adequate notice is required to implement reforms of this nature. We believe that implementation should not start until 2023.

Similarly, we propose a delay to transmission and distribution residual charges reform by one year from 2021 to 2022.

EDF Energy believes that the following approach would better achieve Ofgem's stated objectives:

**a. transmission and distribution residual charges**

- For transmission and distribution residual reform we support a 2022 implementation. Customers are already contracted post 2021 and we are conscious that the date at which the detail is released is too close to the implementation date with further customers contracting by then. This could run the risk of not allowing adequate time for system testing to implement the eventual solution and could risk increasing customers premiums due to uncertainty.

**b. non-locational Embedded Benefits?**

For the non-locational embedded benefits reform, we support an implementation date that gives four years of notice after final determination, i.e. earliest 2023.

- Firstly, the ability to be able to set TGR to zero is not something larger generators had considered legally possible due to the cap in the European Regulation EC838/2010. Ofgem sought to provide assurance noting that future changes impacting GB generators would only happen over a reasonable period of time and that Ofgem had no desire to maximise charges for generators. This proposal has material consequences for GB generators particularly in the short term.



- Secondly, applying BSUoS charges to smaller generators is a new idea and a change of approach by Ofgem and not something smaller generators could have reasonably taken into consideration in investment decisions. A delay to implementation of this reform seems reasonable.

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

No, EDF Energy does not agree with the Ofgem's 'minded to' position in its totality. While EDF Energy agrees with the recommended actions, the proposed implementation dates need revision for the reasons set out above.

**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.**

The practical consideration for delivery of the residual reform hinges on our previous observations of using non-standard data that will be costly to implement and therefore impact overall consumer benefit by several million pounds.

For other embedded benefits as highlighted in the answer to the questions above, we see clear merit in a controlled roll-out to ensure a package of reform is delivered that takes into account decisions that investors have made and also importantly ensures that wider reforms that be usefully included to make these changes sustainable overall.

**END**