The voice of the energy industry

Energy UK response to Ofgem's Targeted Charging Review

May 2017

About Energy UK

Energy UK is the trade association for the GB energy industry with a membership of over 90 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry from established FTSE 100 companies' right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 26 million homes and every business in Britain. Over 619,000 people in every corner of the country rely on the sector for their jobs with many of our members providing lifelong employment as well as quality apprenticeships and training for those starting their careers. The energy industry adds £83bn to the British economy, equivalent to 5% of GDP, and pays over £6bn in tax annually to HMT.

Executive Summary

- Energy UK acknowledges that this response on the proposed Targeted Charging Review (TCR) should focus on whether a Significant Code Review (SCR) is appropriate and its proposed scope. Focusing on solutions at this stage would be premature.

- Energy UK generally supports the SCR process if timely, well directed and focused. Members welcome Ofgem's decision to lead this review. Guidance and feedback from the regulator is always helpful to industry and ensure the most efficient outcomes. Ofgem should have a strategic vision for the future that industry can work towards.

- Energy UK believes that any recommendations to change the structure of network charging should consider the extent to which possible future changes to the use and management of energy demand and generation. New developments to consider include smart metering, smart networks combined with moves towards the wider utilisation of electric heating, electrification of transport, EVs and Demand Side Response (DSR). Generation will continue to decarbonise with more renewables and peaking plant in future along with storage. Designing a system that is flexible to change in order to avoid a similar review of charging in the near future is important.

- We are supportive of arrangements that provide enough lead time for the retail industry to respond to changes.

- Energy UK's 2016 Electricity Charging Arrangements report[1] advocates that any review of charging needs to take a holistic and comprehensive approach to ensure that unintended consequences are minimized, ensuring the optimal result for the customer. There may be specific issues which can be addressed with more urgency than could otherwise be delivered within a wide ranging review. Ofgem needs to ensure that its project management is robust and effective to ensure joined up thinking.

- Energy UK is supportive of a proposed Charging Co-ordination Group (CCG) that would lead with a strategic direction. We recommend that the CCG should be representative of the industry, and supported by the System Operator as its steps up to providing a more enhanced role in facilitating industry change.

[1] https://www.energy-uk.org.uk/publication.html?task=file.download&id=5903

- Energy UK is aware that Ofgem will be publishing it's future focus work on charging that will be considering other aspects of the Transmission and Network Use of System (TNUoS) charge and while it is understandable that Ofgem may want to manage its work load by separating these issues, it is important that the decision making process considers the whole picture.

If Ofgem would like to discuss any of the points in this response, please do not hesitate to contact Barbara Vest (Barbara.vest@energy-uk.org.uk). Energy UK is happy to facilitate a round table Ofgem to discuss out position.

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Question 1: Do you agree that the potential for residual charges to fall increasingly on groups of consumers who are less able to take action than others who are connected to the system, is something we should address?

Yes, Energy UK agrees that there is potential for residual charges to fall increasingly on groups of consumers who are less able to take action than others connected to the system and that this is something that Ofgem should be addressing. All users should pay a fair contribution to the common costs that are incurred to run the network.

However, Energy UK believes that there are other considerations that Ofgem should be looking at. Please refer to the agreed key asks by Energy UK's membership in our charging report[2].

Question 2: If so, why do you think, or do not think, action is needed?

The current charging arrangements were established twenty years ago with many various amendments and additions along the way. The arrangements were made for a different energy system than what we have now and as such, Energy UK believes that with Ofgem's new powers, there is now is an opportunity to review the whole charging framework to ensure it is fit for purpose going forwards.

The current Triad and charging arrangements mean that it is possible for Half Hourly (HH) connected users to avoid paying the TNUoS residual charge which is of sufficient size to warrant Ofgem exploring whether alternative approaches would be preferable. Behaviour that benefits the system should be appropriately rewarded, and incentivised to do so.

Energy UK supports the proposed SCR, and the other elements that Ofgem has proposed to look at. However we would also like to see other elements reviewed; such as connection charging and a full review of BSUoS.

Ofgem should be mindful that in any future charging regime, due consideration must be given to the balance between creating appropriate price signals to trigger investment and behavioural change, and the need to protect consumers that may not be in a position to respond, such as those who are still on a non-half hourly meter (NHM) or unable to avoid TNUoS charges.

Question 3: We are proposing to look at residual charges in a Significant Code Review. Are there any elements of residual charges that you think should be addressed more urgently? Please say why.

Energy UK considers that Ofgem should make a decision on CMP264/265 in the first instance which it has already stated it would do.

Energy UK considers that it is important that Ofgem considers CMP264/265 holistically and looks at the impacts that this decision will have on different parts of the charging regime. Furthermore, the rate and pace of change needs to be considered in light of the need to maintain investor confidence at a time when the energy system needs significant investment. This will help to deliver a charging methodology which is cost-reflective, transparent, stable, and fair.

The current charging arrangements are complicated and Energy UK members agree that they are in need of review. Ultimately, any changes to electricity charging arrangements should not negatively impact upon consumers. Changes to the charging regime should be cost reflective and not negatively impact the consumer bill. If left unchanged, it is likely that any distortions between transmission and distribution connected generation as well as different types of technology will widen

Ofgem should be able to use the work undertaken to date on a number of related/relevant CUSC change proposals. Energy UK believes that it is right for Ofgem to deal with some issues relevant and impacted by the proposed SCR.

[2] https://www.energy-uk.org.uk/publication.html?task=file.download&id=5903

As stated in the Energy UK Electricity Charging Report, Ofgem should be mindful that energy retailers would like to see sufficient lead time prior to any changes taking effect as many suppliers will have fixed contracts with customers in place for a period of 12 – 36 months as well as requiring sufficient time to make changes to IT systems. This will prevent windfall gains and losses, and potential reduce risk premiums.

Throughout the review, Energy UK would like to see evidence of Ofgem's robust project management plan and effective use of the Charging Co-Ordination Group (CCG) to ensure joined up thinking across the piece. Energy UK has noted in our charging report that a whole systems approach needs to be taken.

Question 4: Are there elements of the approaches in other countries that you think could be appropriate for GB residual charges?

Energy UK believes that Ofgem should look to other countries' approaches to network charging. Energy UK is not however in a position to comment on which regime, if any, GB should model its charging arrangements on. The selection of countries in the study by TNEI seemed somewhat random (based on the language skills of the consultancy team). We would encourage Ofgem to undertake further targeted and systematic literature review.

Ofgem should continue to support debate in Europe advocating cost-reflective transmission charging within the internal electricity market, based on the GB model, to minimise any distortions of cross-border trade. Ofgem should continue to assess options for introducing cost-reflective network charging for balancing and transmission so levels are harmonised for GB generators via-a-vis the rest of the EU.

Question 5: Are there other approaches that you know about from other jurisdictions, that you think offer relevant lessons for GB?

Please refer to Energy UK's answer for question 4.

Question 6: Do you agree that our proposed principles for assessing options for residual charges are the right ones? Please suggest any specific changes, or new principles that you think should apply.

By and large, Energy UK agrees with the principles that Ofgem has highlighted in the consultation; comprising fairness, removing distortions, and proportionality and practical considerations.

<u>Fairness principle</u>

Ofgem has highlighted the 'fairness' principle which should ensure that those who are vulnerable or unable to respond to signals are being considered and protected. It is necessary to strike a careful balance between the delivery of a fully cost-reflective system, and the need to deliver a fair energy system which benefits the end consumer. For example, domestic consumers who live on the far reaches of the distribution network impose costs upon the network. It would be inappropriate to charge these consumers the full cost-reflective price for their connection to the distribution network. To do so would often be financially unviable for such consumers and risk driving them towards a less efficient, islanded arrangement. Issues of 'fairness' are also particularly significant for development of any future arrangements that require considerable levels of consumers to engage to a significant degree in order to consumer engagement in order to benefit from them.

The introduction of time of use tariff structures, while beneficial both to the system and to engaged consumers, risk shifting significant costs on those consumers that are unable to engage fully with the retail market. Such issues significantly affect domestic consumers on low incomes, or who are otherwise vulnerable. Vulnerable and inflexible customers could be provided relief through complementary policies/measures.

<u>Removal of distortions principle</u>

Energy UK supports any principle that will remove distortions and would like to see a more cost-reflective charging regime with complimentary policies that would take into consideration the fairness principle.

Proportionality and practical considerations principle

Energy UK supports proportionality and practical considerations as a principle. The design of future network charges is important and should be as simple as is reasonable. Ofgem as the regulator should lead communication for ensuring changes and impacts are clearly explained to consumers. Energy UK believes that it is important that Ofgem ensures that stakeholders are engaged and kept up to date on any review that is conducted.

- We would like to see Ofgem dedicate a page on its website which captures agendas, minutes, other papers and sets meeting dates 6 months ahead, and a list of contacts attending, for all meetings that Ofgem is chairing in regards to the review. There should be reasonable opportunity for stakeholders to read the material and contact a representative on the working groups in order to engage with the debate.
- Further to this, Energy UK would like to see a monthly bulletin that is similar to the Joint European Stakeholder Group bulletin that National Grid runs. This is a user friendly bulletin that captures updates, provides relevant links to documents, upcoming meetings, and wider context of changes.

Other principles Ofgem should consider

In Energy UK's published Electricity Charging Arrangements Report 2016, we highlighted other principles that Energy UK would like to see taken on board.

- Ofgem should also be considering the importance of **stability and predictability** to industry; stability and/or predictability are important elements of a charging regime helping generators/demand to accurately forecast revenue and thus providing additional certainty, aiding investment decisions. We note, however, that there are some trade-offs between cost reflectivity and stability of charges.
- Energy UK believes that **cost reflectivity** is also a key principle. Transmission and distribution connected generation should be exposed to charges that are appropriate and cost-reflective, taking into consideration the impact on the rest of the network. We support the principle of using peak demand as the basis for relevant elements of network charging to reduce peak electricity demand and avoid network reinforcement. The value of charge avoidance as well as the wholesale electricity price should be considered together when looking at how to manage these peaks.
- Ofgem should consider that **locational signals** provide a clear indication of the optimal site to gain the best rewards for locating generation near to demand (and vice versa). Such signals must be cost-reflective to drive appropriate behaviour from market participants in conjunction with other price signals in the market. This ensures the efficient development of the Main Integrated Transmission System (including the distribution network) to ensure the most efficient use of assets.
- Energy UK believes that **market signals** should allow participants to respond to price signals allowing for the efficient operation of the system. Therefore, where such signals only become apparent ex-post and the ability to forecast these signals is limited, consideration should be made as to whether to adopt a fixed, forecastable charging methodology.
- **European harmonisation** is still a key principle going forward for Energy UK members. The range of different charging methodologies across Europe creates a very complex system which is hard to compare with GB on a like-for-like basis. Greater harmonisation of tariff structures with Europe should be promoted to ensure generation across EU Members States competes on a level playing field.
- Energy UK believes that any recommendations to change the structure of network charging should consider the extent possible **future changes** to the use and management of energy consumption. New developments to consider include smart metering, smart networks

combined with moves towards the wider utilisation of electric heating and the electrification of transport. Generation will continue to decarbonise with more renewables and peaking plant in the future along with storage and Demand Side Response (DSR).

- In order for participants to understand the charging arrangements, and more importantly respond to them, it is important that they are fully **transparent**. This means that the charges should be clear along with the methodologies used to set them. Additionally, information should be provided on any assumptions and data used to set charges.

Question 7: In future, which of these parties should pay the transmission residual charges: generators (transmission-or distribution-connected), storage (transmission-or distribution-connected), and demand, and why? What proportion of these charges should be recovered from each type of user?

Please refer to Energy UK's charging report that provides further detail on what parties should be paying transmission residual charges and the proportion of these charges.

Question 8: In future, which of these parties should pay the distribution residual charges: generators (transmission-or distribution-connected.), storage (transmission-or distribution-connected), and demand, and why? What proportion of these charges should be recovered from each type of user?

Please refer to our answer to question 7.

Question 9: Do you support any of the five options we have set out for residual charges below, and why?

Energy UK considers this to be an important debate to be had by industry which is the purpose of the proposed targeted charging review and indeed, the SCR. We would like to see the options further discussed in greater detail during the process. Throughout the process, Ofgem should keep in mind that Energy retailers advocate that the outcome should be simple and practical from an industry billing and supply billing perspective.

It is important that the residual charges are considered in the context of anything else that Ofgem proposes on its forward focused work. Energy UK believes that options for the future of the residual and other elements of TNUoS should be looked at together when making the decisions.

Question 10: Are there other options for residual charges that you think we should consider, and why?

Energy UK does not see that there are any other options at the moment. Energy UK supports the TCR being taken forward and believes that the options should be fully explored throughout the SCR.

Question 11: Are there any options that you think we should rule out now? Please say why.

While Energy UK believes that options should be fully explored when the SCR is launched, we also believe that the status quo should be categorically ruled out as an option that is considered going forward. The current charging regime cannot continue in the long term and should be ruled out from the offset.

Question 12: Do you think we should do further work to analyse the potential effects of the charging arrangements for smaller EG (called 'embedded benefits')?

It is right that Ofgem is looking at the potential effects of the charging arrangements for smaller embedded generation, but Ofgem should also consider the potential effect of the charging

arrangements for bigger assets, on security of supply, for investment in the UK, and how it will impact on the flexibility agenda[3].

It is important that the charging arrangements and the flexibility work streams are considered concurrently. Considering all arrangements together is key to ensuring a level playing field for all energy market players. Independent research should examine the impacts of charging, grid and market access arrangements - identifying the differences between transmission and distribution connected generation.

Question 13: Do you think changes are needed to the current charging arrangements for smaller EG, and when should any such changes be implemented?

Energy UK would like to see Ofgem support and acknowledge the requirement for a level playing field between embedded generators and transmission connected generation in terms of accessing markets. We would also believe that Ofgem should prioritise future work based on materiality and should aim to align changes concurrently. The demand residual payments are material.

Currently connection charges on the distribution network and connection charges on the transmission network are different which represents a distortion. Distribution connected assets have to pay a deep charge for connections, whereas transmission connected assets pay a shallow cost. Energy UK believes that Ofgem should be considering this as a part of the TCR. While Ofgem may be considering this as a part of its future work, without sight of this work it will be difficult to avoid unintended consequences from a piecemeal approach.

Question 14: Of the embedded benefits listed in our table, do you think that any should be a higher or lower priority?

Please refer to question 13.

Providing a decision on CMP264/5 is a priority for Ofgem and the demand TNUoS residual is distortive, Ofgem should consider other charging arrangements. BSUoS arrangements for not only smaller embedded plant, but for the whole industry. It is not clear why BSUoS arrangements for a specific technologies being targeted when there should be a wider review of BSUoS arrangements.

The TNUoS Generation residual and TNUoS Locational charges are less material but Ofgem should aim to progress them concurrently.

Question 15: Do you think there are other aspects of transmission or distribution network charging which put smaller EG, or any other forms of generation or demand, at a material disadvantage?

Energy UK published an Electricity Charging Arrangements report last year which details Energy UK member's key recommendations for change to the charging regime in GB (see footnote 1). Energy UK members see the future as having one set of charging arrangements for distribution and transmission network. Where possible these regimes should be merged.

There are other areas where Ofgem could support, and address the inconsistency between EG and transmission connected generators.

- Ofgem should take steps to level the playing field by supporting solutions in relation to IT systems.
- National Grid has shared its intentions to reform the Ancillary Services Market[4], a part of which involves creating a level playing field for participants to tender for these services. Ofgem should support National Grid in this work. Enabling more competition in this area can only mean lower costs to consumers.

[3] Please see Energy UK's Response to the Call for Evidence on a Smart, Flexible Energy System for further information - https://www.energy-uk.org.uk/publication.html?task=file.download&id=6007
[4] Please see Energy UK's report on Ancillary Services for further information - https://www.energy-uk.org.uk/publication.html?task=file.download&id=6138

- Connection charges also present a material disadvantage to DG customers. Energy UK also recommends that Ofgem consider connection charges which can put EG at a material disadvantage. Deep charges on the distribution network verses the shallow charges on the transmission network.
- Energy UK would like to see a wider review of BSUoS. Looking at network charging arrangements in isolation is likely to create unintended consequences and is likely to exasperate market distortions and any inefficient costs for consumers.

Energy UK is expecting to see more new entrants in the future and therefore Ofgem should be considering all parties' ability to participate in the market in terms of cost reflectivity, simplicity, predictability and access to market.

Question 16: Do you agree with our view that storage should not pay the current demand residual charge, at either transmission or distribution level?

A level playing field between different assets providing flexibility is required across all markets to allow the most efficient deployment of technologies.

With respect to the charging elements which collect revenue, storage assets are not final consumption and therefore, storage should not pay the element of network charges which relate to collecting revenue from final consumption. Please refer to Energy UK's response to the Flexibility Call for Evidence for further information on this (footnote 3).

Question 17: Do you agree with our view that storage should not pay BSUoS on both demand and generation?

Please refer to Energy UK's response to the Flexibility Call for Evidence for further information on this.

Question 18: Which of the BSUoS approaches describe is more likely to achieve a level playing field for storage?

Energy UK members agree that Ofgem should be considering BSUoS and storage in the TCR. Energy UK would like to see a full review of BSUoS, not just for specific technologies. This was a recommendation agreed upon by members in Energy UK's Electricity Charging Arrangements Report.

Question 19: Do you think the changes in this chapter should be made ahead of any wider changes to residual charging that may happen in future? Do you agree with our view that these changes should be implemented by industry through the standard code change process?

Energy UK believes that charging arrangements should facilitate a level playing field. Storage developers need clarification and therefore would like to see these changes brought outside of the SCR. However there is a risk that there are further distortions created by singling out one type of network user only which could be avoided by including this work in the SCR.

Question 20: We would welcome your thoughts on the potential make-up of a CCG. Please refer to the potential role, structure, prioritisation criteria and assessment criteria.

Energy UK is supportive of the concept of a CCG. Energy UK believes that there is value to having a group that oversees changes to charging and wider policy that may affect charging arrangements.

Energy UK believes that Ofgem should be mindful of past experiences setting up similar groups, for example, the group that were set up by Xoserve to deal with Project Nexus. These groups were outside of the formal governance arrangements under the Uniform Network Code. Ofgem should consider establishing deliverables for the CCG, which would lead to changes to the charging regime. Energy UK would recommend using Xoserve's experiences to inform the establishment of the CCG.

The CCG should be populated by decision makers within industry, who are able to consider charging strategically across the piece. Ofgem should ensure that there is sufficient customer representation, as

well as generation representation and new entrant technology providers. Ofgem needs to ensure that that there is a route for stakeholders to have their voices heard throughout the debate.

We note that the CCG were to be populated by the same members who are a part of the modification work groups i.e. the experts, then it is likely that parties are unable to attend both modification workgroups and the CCG because formal governance arrangements will take precedence.

Ofgem should also consider that for all participants, and particularly smaller ones, resources are limited and regulatory teams are already stretched, therefore industry parties are unlikely to attend a range of technical working groups that are not linked to the formal modification processes.

That said, it is important that Ofgem monitors other industry and work group meetings taking place in the industry throughout this process. One way in which this can be achieved, is if code administrators jointly kept an industry calendar. Energy UK would be supportive of a joint industry diary managed by code administrators that was visible to all participants.

Question 21: Do you agree with our proposed delivery model, including its scope?

While we agree that the residual is one of the biggest distortions that needs to be looked at, the scope of this review appears to be fairly narrow. As is outlined in Energy UK's Electricity Charging Arrangements Report published in 2016, there are several areas that were not included anywhere, or fully, in Ofgem's proposed review that Energy UK believes should be. This includes;

- Ofgem should consider how behind the meter generation and turn up demand side response are charged in the future.
- Ofgem has addressed some elements of BSUoS in this review, Ofgem should consider a full review of the range of components that contribute to BSUoS charges. Ofgem should appoint an independent review of BSUoS charges to be conducted by Elexon for example. The BSUoS review has to be considered, again in conjunction with the other changes that are going on in the market, and feed into the CCG.
- Connection charges should be considered and they are not addressed anywhere in this consultation. Connection charges represent a significant cost to developers.

Ofgem should be mindful that a charging review such as this will create some uncertainty for industry, and while it is necessary, Ofgem should take care to ensure that solutions are as future proof as possible to avoid another review and uncertainty for industry.

Question 22: Do you agree that our proposed SCR process is most appropriate for taking forward the residual charging and other arrangements for smaller EG discussed in this document?

We agree that a holistic approach is appropriate to ensure that the distortions do not manifest themselves in other areas of the electricity system, as failure to do so could result in ever higher costs faced by GB consumers. There may be specific issues which can be addressed with more urgency than could otherwise be delivered within a wide ranging review, however, ensuring that all issues are taken forward holistically is important to ensure other parties are not unfairly discriminated against.

Energy UK notes that some topics should be progressed quicker than would otherwise be progressed through the TCR.