



Targeted Charging Review: Consultation Ofgem March 2017

Stag Energy Response
5 May 2017

STAG ENERGY

Stag Energy is a British company focused on the development of energy infrastructure assets in support of secure, affordable energy supplies while meeting the Government's low carbon objectives. The company draws on a depth of experience in the energy sector. The Stag Energy management team has been involved in the creation and delivery of over 10,000 MW of power generation and related infrastructure projects worldwide and raising over £6bn of private sector financing.

In the UK power sector, Stag Energy is currently leading the development of new generation facilities designed to provide low cost, reliable capacity to support system security of supply. Stag Energy has supported Watt Power Limited ("Watt"), a new market entrant in the last decade, to develop ~150MW of reserve power projects which secured Capacity Agreements in the 2014 & 2015 electricity capacity market auctions.

Stag Energy was also responsible for the successful development of four 299MW transmission connected gas-fired generation projects, which continue to utilise the ongoing support and project management services of Stag Energy.

Stag Energy recognizes the need to balance commercial considerations with environmental issues when developing energy projects and is confident that this can be responsibly delivered at a local level.

COMMENTS ON OFGEM'S TARGETED CHARGING REVIEW

Embedded Benefits and the SCR

Stag Energy is grateful for the opportunity to comment on the proposed Targeted Charging Review (TCR) and support Ofgem's intention to carry out a Significant Code Review (SCR). However, we think it is essential that any decision on CUSC modification proposal 264/5 be deferred until a SCR is undertaken. Rather than implement the current minded-to position on CMP 264/5, an approach in keeping with Ofgem's responsibilities would be to cap TNUoS Demand Residual (TDR) payments at current levels, to allow Ofgem the time to undertake a holistic review of system charging arrangements (by way of a SCR), after which longer term solutions can be proposed and implemented with the support and understanding of the whole generation sector. CMP 264/5 WACMs 7, 8, 9 or 10 could all be implemented to either freeze TDR payments or cap TDR payments at lower levels while Ofgem undertakes the necessary SCR. We recognise that this is a substantial piece of work, however, we are convinced that such work is necessary to properly address a complex labyrinth of issues associated with the current charging arrangements to create a stable system of charges for industry and investment going forwards.

Principles of Transmission Charging

In considering the changes required to charging arrangements we note Ofgem's comments regarding principles of reducing distortions, fairness, and proportionality. These principles are vague and subjective and to avoid confusion and unintended consequences we feel that it would be desirable to apply a more objective set of criteria against which new charging arrangements should be tested. We would suggest the following criteria be used as key tests for new charges:

Actual Cost Reflectivity: Charges must reflect, as far as possible, the true marginal cost of dispatching electricity from the point of generation to the source of demand on an average basis. As such,

“forward-looking” charges must be transparent and should not contain hidden subsidies for off-shore wind, for example.

Infrastructure Focused: Residual charges should be based on long term, realistic estimates of the cost of new investment in both national and local transmission network infrastructure. These estimates of the quantum to be recovered through transmission charging will need to take full account of the National Grid’s forecasts of system requirements and, more importantly, the Government’s policies in order to encourage new investment in particular generation technologies.

Energy Policy Neutral: The chosen methodology for transmission charging itself should not be distorted to help implement particular energy policies whether that be, for example, financially incentivising smart metering, onshore or offshore renewable energy generation or wave power at the national or local level.

Social Welfare Neutral: All consumer charges have an income distribution impact but it should not be the job of Ofgem, or suppliers, to use charging to try and compensate poorer consumers. Instead, fuel poverty and energy efficiency issues should be addressed by the government through promoting some form of tax or benefit allowance, or by covering some elements of the low carbon programme from general taxation.

Some Key Issues for Consideration

Beyond the principles for charges described above, Stag Energy have considered four key themes around charging arrangements – Market Responsiveness, Generation Charges, Demand Charges, and Welfare Issues – and our comments on these themes are summarised below.

Market Responsiveness: Charging arrangements are often used to incentivise market behaviour, however, due to the high levels of inelasticity in both the industrial and residential electricity market, charging arrangements only have limited capacity to drive energy consumption. The fundamental inelasticity of the market accounts for (a) the challenge of energy efficiency policies, and (b) the low level of “known” up-take for things such as DSR, and likely impact of metering on consumer buying behaviour. Zonal differential pricing may well impact new investment in wind farms off-shore but, generally speaking, the variation in charges does not impact significantly on consumption. Instead, the themes below should be more heavily weighted when designing charging arrangements.

Generation Charges: The current charging regime must be revised as it is no longer fit for purpose and does not send the right signals to those connecting to and using the electricity network. The problems are certainly wider than who pays the residual charges – Ofgem needs to consider the more fundamental drivers causing increases in TSO and network costs. We believe that the biggest current driver for rising costs is investments to connect renewable generation, which is usually at a large distance from consumers, especially in the case of offshore wind developments. As a general rule, we believe that generation charges should be related to the marginal cost of delivery. Therefore, if offshore wind farms are creating larger costs for the network it should follow that costs are more clearly assigned to these generators. In addition, we consider that charges should be variable based on use of system and that the balance of charges between Generation and Demand should be reassessed, especially against the backdrop of Brexit.

Demand Charges: As noted above (see Market Responsiveness) demand is generally inelastic. For residential consumers, price elasticity is less than 1. Only in those sectors of industry where independent/on-site generation is possible, or users can enter into specialised deals with NG and/or suppliers, does the published data show that elasticity scores of 2 or 3 are possible, either due to

switching supply or turning off demand. The data indicates that most of the rest of the industry, including SMEs, are price takers. This is essential to consider when designing demand charges. Stag Energy believe that a single flat charge for all consumers would help minimise distortions. Such a charge should also be applied to consumers with on-site generation, such as solar panels, whose ability to access the grid at any time their on-site generation is not in operation, must be appropriately reflected in charges. Finally, we also believe that Ofgem *and* BEIS, need to discuss whether the cost of environmental policies is best paid by electricity customers, or whether they could be better supported by tax payers.

Welfare Issues: As a general principle fuel poverty should be dealt with by the tax/benefits system. It is not the job of Ofgem or suppliers to subsidise poor consumers. A cap on variable electricity rates would inevitably disrupt the operation of the wholesale market and investment signals. In addition, fixing prices in an inelastic market (such as the domestic electricity market where the price elasticity for residential consumers is less than 1) will always lead to negative impacts on the poorest more than any other sector of society. The government should not therefore seek to tackle fuel poverty through electricity price caps. Charging arrangements going forward must be designed to be “welfare neutral”.