
Targeted Charging Review Minded To Consultation: UK Steel Response

February 2019

UK Steel, a division of EEF, is the trade association for the UK steel industry. It represents all the country's steelmakers and a large number of downstream steel processors.

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.

Energy intensive industries such as steel are already seeing their international competitiveness and ability to invest hindered by high industrial electricity prices¹. A key contribution to this is the discounts some of the UK's key competitors offer energy intensive industries discounts on their electricity transportation costs. While Ofgem's focus on protecting domestic consumers is understandable, there are other measures that can be used to help the fuel poor and consideration must also be given to the wider benefits to the UK economy, public services etc., of a healthy industrial base.

We would also note that the UK policy environment seems particularly inconsistent when it comes to onsite generation and demand side response (DSR). The government is supposedly championing flexible, decentralised sources of generation. The TCR, whether justified or not, runs in a completely different direction, removing incentives on which investments had been made and making investors ever more convinced of the unreliability of UK policymaking in this area.

¹ UK Steel, 2018, The Energy Price Scandal: A Fair Power Deal For UK Steel

Against this context, the key issue for steelmakers is not the theoretical basis on which charges are levied but the end impact on their bills. It is vital companies can see this clearly in order to comment on the two options offered and prepare for the changes ahead.

With that in mind, we have been very disappointed at the quality of the information provided. Ofgem has had to clarify a number of points during the consultation, with the latest update coming less than two weeks before the closing date. Even then, there are considerable uncertainties in the figures provided. 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 elements of charges that could 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 last year 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 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.

There are two further issues causing uncertainty for our sector. The first is that we are told the reward for DSR being removed under the TCR will be reinstated where appropriate through the Access & Forward-Looking Charges Review (AFLC) review. The AFLC review will also 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. Despite promises that the two reviews are aligned, there are no clues yet as to the reward the AFLC review might provide for any kind of onsite generation or demand management. The second, very fundamental issue is that the wider benefits supposedly delivered by the TCR are reliant on the currently non-operational Capacity Market.

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 this work 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.

As discussed above, 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. Research by UK Steel shows 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 plants. Any increase at all in these disparities would be very detrimental to the sector. 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 however 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. Also noting that not all onsite generation is an optional extra, in the example of steel it is an efficient way in which to use a waste gas and an integral part of the plant's functionality.

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.

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 and/or between locations 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 deemed 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?**
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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, with many sizeable inequalities being 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. We are also concerned at the degree of uncertainty still inherent in the figures and, as noted previously, at 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 based on previous information supplied by Ofgem suggest collective costs could increase for EHV and Transmission-connected customers by £100m under the fixed charges scenario, potentially an average price increase of £5/MWh. 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 facing additional costs 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. 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.

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