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Dear Andrew

**Re: Targeted Charging Review: minded to decision and draft impact assessment**

Thank you for the opportunity to respond to [your consultation](#). This is a SIMEC response on behalf of the [GFG Alliance](#). The Alliance encompasses power generation, metals and engineering, mining, financial services and property. We have a large generation and industrial demand portfolio across GB and are materially exposed to transmission and distribution network charges. The metals and metal products we produce are subject to international competition, which severely limits our ability to pass through cost increases our competitors aren't exposed to. Energy costs materially affect our production costs, exceeding 20% of Gross Value Added (GVA) at several sites. Ensuring our network charges are reasonable is a key priority for our and GB's industrial businesses.

**Summary views on the consultation**

1. "Fixed residual charges" will better meet Ofgem's objectives of reducing distortions, fairness and proportionality than capacity or volume based charges.
2. However, "fixed residual charges" as currently proposed mean 132kV connected demand in Scotland will face charges over three times higher than 132kV connected demand in England and Wales, due to different classifications of "transmission" and "distribution". To address this, Ofgem should apply a scaling factor to the charges levied on 132kV connected demand in Scotland to create equivalence with England and Wales and uphold the fairness principle.
3. Ofgem must ensure that "fixed residual charges" are levied on a "per connection agreement" basis, not a "per MPAN" basis. We understand this is the policy intent for transmission and EDCM sites. This policy should be extended to CDCM sites that have connection agreements. Failure to do this will give rise to unfair "double charges" for sites with two (or more) MPANs and create inefficient incentives on users to reconfigure their connection agreements so they only have one MPAN.
4. Ofgem should put beyond doubt that "fixed residual charges" will not apply to generators that occasionally use electricity supplied by electricity networks, for example when on outage. We

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understand it is Ofgem's policy intent to exclude generators from residual network charges but the "minded to" decision should have made this clearer.

5. We support an implementation approach which phases in the new regime of residual network charges over three years. It is almost certain that some industrial users will face large increases in their charges, with little or no pass through ability. A three year phase in of reforms upholds the fairness principle.
6. Significant industry work will be required to implement a regime of "fixed residual charges". In the interests of carrying out this work properly, implementation of "fixed residual charges" should commence no sooner than April 2021 (and be subject to a three year phase in).
7. We have some concerns that the estimated values for "fixed residual charges", particularly EDCM charges, appear heavily caveated – and could outturn at significantly different levels from the figures published in the "minded to" subsidiary documents. Our response assumes the published figures are a reasonable representation of the outturn figures. Ofgem should prioritise improving the certainty of these values before making its final decision.

I trust these views are useful. Please contact me if you wish to discuss.

Yours sincerely,

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## Responses to specific consultation questions

### How we reached the leading options

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

Yes, subject to generators not being liable for residual network charges when they occasionally “*use the electricity supplied by electricity networks*”, for example when on outage. We understand it is Ofgem’s policy intent to exclude generators from residual network charges but the “minded to” consultation should have made this clearer.

It would be highly disproportionate to levy residual network charges on generators for low and occasional levels of consumption (e.g. for outages), particularly if Ofgem’s preferred option of “fixed residual charges” is implemented, where the size of the residual charge is determined by connection voltage level. Generators tend to be connected at higher voltages and would be therefore be exposed to the highest residual charge bands if the TCR reforms failed to exclude them.

As CDCM generators have a “generation” tariff assigned to them under the DUoS charging methodologies, and there are measures such as GC and DC values to identify “generation” at transmission level, it ought to be possible to exclude generators from “residual” network charges in billing systems without great difficulty.

#### **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.**

No specific comments.

#### **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 have not identified a better approach to residual charges than charging users based on the costs of the voltage level of the network to which they are connected and the higher voltage levels of the network.

#### **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.**

Overall, we believe Ofgem’s objectives of reducing distortions, fairness and proportionality will be better served by “equality within charging segments” (i.e. “fixed residual charges”) than capacity based or volume based charges.

However, the approach of “equality within charging segments” creates a major anomaly for 132kV connected demand sites, because 132KV is classed as “transmission” in Scotland but “distribution” in England and Wales. Ofgem should therefore make an adjustment to the “fixed residual charge” methodology, to address this distortion and ensure fairness in the 132KV charging segment.

### **132kV distortions from “fixed residual charges” as currently proposed**

To illustrate the 132kV “fixed residual charge” distortion, we include an example of a Scottish industrial site within the GFG portfolio, and contrast its residual charges with an equivalent site in England and Wales.

GFG owns and operates a site known as Liberty Steel Dalzell. The site is a 132kV connected Scottish demand site manufacturing steel plate. The site was reopened by GFG in autumn 2016, having been mothballed by its previous owners on economic grounds in 2015<sup>1</sup>. Its average demand is ~1.5MW and its average TRIAD demand is similar, at ~1.3MW.

The impact of “fixed residual charges” on the (132kV transmission connected) Dalzell site versus the status quo and an equivalent 132kV connected demand site in the North East England DNO region (Ofgem’s representative region) is shown below:

	(Southern) Scotland demand site	Northeast England demand site	Difference
Connection voltage	132kV	132kV	-
Classification	Transmission connected	Distribution connected (EHV)	Yes
Ave Demand	1.5MW	1.5MW	-
Ave TRIAD demand	1.3MW	1.3MW	-
Current residual charges	£65k <sup>2</sup>	£90k <sup>3</sup>	-£25k
Fixed residual charge (proposed)	£550k <sup>4</sup>	£155k <sup>5</sup>	+£395k
Increase versus current (£)	+£485k	+£65k	+£420k
Increase versus current (%)	+745%	+70%	+675% pts

### **Solution to the 132kV distortion**

We propose the application of a scaling factor to transmission residual charges levied on 132KV demand sites in Scotland. This would ensure better alignment of residual charges on 132kV connected demand in

<sup>1</sup> This was reported in the media at the time, for example this [article in the Scotsman](#).

<sup>2</sup> 1.3MW average TRIAD demand x 2019/20 TNUoS Demand Residual charge = £65k

<sup>3</sup> EDCM residual estimated to be ~40% of TNUoS demand residual. £65k + £25k = £90k. Our proxy for the EDCM demand residual charge is based on other EDCM sites in the GFG portfolio, due to a lack of public data on current EDCM residuals.

<sup>4</sup> Figure 8 (page 42) of Ofgem’s TCR “minded to” decision document

<sup>5</sup> Figure 7 (page 41) of Ofgem’s TCR “minded to” decision document

Scotland, England and Wales and address the significant failing against Ofgem's fairness principle that currently arises. The application of a scaling factor of 0.28 to the "fixed transmission residual charge" to 132kV connected demand in Scotland would address this unfairness and retain the benefits of "fixed residual charges" in all other respects.

We illustrate the impact of our proposed scaling factor below:

	(Southern) Scotland demand site	Northeast England demand site	Difference
Connection voltage	132kV	132kV	-
Classification	Transmission connected	Distribution connected (EHV)	Yes
Fixed residual charges (current proposal)	£550k <sup>6</sup>	£155k <sup>7</sup>	£395k
Proposed scaling factor for 132KV demand sites in Scotland	0.28	-	Yes
Fixed residual charges with scaling factor	£155k (i.e. £550k x 0.28)	£155k	£0

**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)?**

Yes, provided that locational network charges adequately recognise the value (or cost) to the networks of reducing (on increasing) consumption at a particular location (be that through demand management or onsite generation).

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

It is difficult to know precisely what the consumer benefits of the lead reform options will be. However, we believe "fixed residual charges" will yield greater benefits than either capacity or volume based charges in terms of reducing distortions. Capacity (or volume) based charges will continue to incentivise users to reduce their agreed capacity (or consumption volume) in order to reduce their exposure to residual network charges, even though reducing capacity (or volume) is deemed not to reduce total network costs. Fixed charges give users no incentive to vary their capacity or consumption to avoid residual charges and will therefore reduce distortions more effectively than capacity or volume based charges.

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

<sup>6</sup> Figure 8 (page 42) of Ofgem's TCR "minded to" decision document

<sup>7</sup> Figure 7 (page 41) of Ofgem's TCR "minded to" decision document

Yes. We would add that “gross charging”, which is not a lead option in your “minded to” consultation, would be particularly onerous to implement, and require extensive new metering and data flows, at significant cost to the industry and ultimately consumers. Gross charging would also be less effective than fixed charges at reducing distortions.

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

Broadly, we believe that setting bands of “fixed residual charges” based on Line Loss Factor Class groups is a reasonable way to apportion residual charges, subject to the distortions at the 132kV demand level in Scotland being addressed (see our response to Question 4).

We believe the fairness of residual charge apportionment under the Capacity based option is debatable. Users without a formal agreed capacity with the DNO are only constrained by the size of their fuse in their property, which would typically be 60A or 100A for domestic premises. This equates to a capacity limit of 14kVA and 23kVA respectively, whereas Ofgem proposes to deem domestic capacity at just 4kVA in 75% of cases (and no more than 8kVA in any case). A different interpretation of deemed agreed capacity for domestic users could give a radically different apportionment of residual network charges than set out in the “minded to” consultation. This is another reason why “fixed residual charges” are a better option than capacity based charges, as there is less need for major discretionary judgements in the apportionment rules.

**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?**

Broadly, we agree that setting bands of “fixed residual charges” based on Line Loss Factor Class groups is a reasonable way to apportion residual charges. However, we believe two adjustments to the methodology should be made to reduce distortions and ensure fairness.

First, to reduce distortions, residual charges should be levied on a “per connection agreement” basis rather than a “per MPAN” basis. We understand this is the proposal for Transmission and EDCM demand sites, but potentially not CDCM sites that have a DNO connection agreement. We believe levying residual charges on a “per MPAN” basis creates inefficient incentives on sites with more than one MPAN to reconfigure their connection agreements so all imports are through a single MPAN. As this behaviour would increase total system costs but create no system benefits, it would be best if Ofgem’s reforms did not incentivise it. This inappropriate incentive could easily be addressed by levying residual charges on a “per connection agreement” basis where a connection agreement is in place.

DNOs have the necessary information to map MPANs to connection agreements to ensure that only one set of residual charges per connection agreement would be payable. We see no reason to charge sites with a connection agreement on anything other than a “per agreement” basis, as this is the least distortive and fairest option.

Second, residual transmission charges levied on 132kV connected demand sites in Scotland (which are classed as “transmission connected”) should be subject to a scaling factor to ensure better alignment with residual charges faced by 132kV connected demand in England and Wales. The application of a scaling factor to the “fixed transmission residual charge” to 132kV connected demand in Scotland would address this unfairness and retain the benefits of “fixed residual charges” in all other respects. See our response to Question 4 for detail.

#### **Quantifying the benefits of reform**

**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.**

It is difficult to know precisely what the consumer benefits of the lead reform options will be. However, we believe “fixed residual charges” will yield greater benefits than either capacity or volume based charges in terms of reducing distortions. Capacity (or volume) based charges will continue to incentivise users to reduce their agreed capacity (or consumption volume) in order to reduce their exposure to residual network charges, even though reducing capacity (or volume) is deemed not to reduce total network costs. Fixed charges give users no incentive to vary their capacity or consumption to avoid residual charges and will therefore reduce distortions more effectively than capacity or volume based charges.

#### **Remaining Embedded Benefits**

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

We agree that a taskforce should examine BSUoS embedded benefits before any reform options are formally brought forward.

**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.**

Yes.

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



We believe the taskforce should complete its work on BSUoS embedded benefits before judgements on reform options (including “do nothing”) are made.

### **Transitional Arrangements**

**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 support an implementation approach which phases in the new regime of residual network charges over three years. It is almost certain that some industrial users will face large increases in their charges, with little or no pass through ability. A three year phase in of reforms upholds the fairness principle.

### **Our minded to position**

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

Overall, we believe Ofgem’s objectives of reducing distortions, fairness and proportionality will be better served by implementing “fixed residual charges” than capacity or volume based charges.

However, we believe the proposed regime of “fixed residual charges” should be subject to two improvements:

First, to reduce distortions, residual charges should be levied on a “per connection agreement” basis rather than a “per MPAN” basis. We understand this is the proposal for Transmission and EDCM demand sites, but potentially not CDCM sites that have a DNO connection agreement. We believe levying residual charges on a “per MPAN” basis creates inefficient incentives on sites with more than one MPAN to reconfigure their connection agreements so all imports are through a single MPAN. As this behaviour would increase total system costs but create no system benefits, it would be best if Ofgem’s reforms did not incentivise it. This inappropriate incentive could easily be addressed by levying residual charges on a “per connection agreement” basis where a connection agreement is in place.

Second, residual transmission charges levied on 132kV connected demand sites in Scotland (which are classed as “transmission connected”) should be subject to a scaling factor to ensure better alignment with residual charges faced by 132kV connected demand in England and Wales. The application of a scaling factor to the “fixed transmission residual charge” to 132kV connected demand in Scotland would address this unfairness and retain the benefits of “fixed residual charges” in all other respects. See our response to Question 4 for detail.

**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 detailed implementation of a “fixed residual charge” regime will require considerable industry work, even if Ofgem’s SCR decision is reasonably precise. Sufficient time should be allotted for the code





modification processes to run their course, and for market participants to digest the implications of the SCR decision. Implementation should commence no sooner than April 2021 (and be subject to a three year phase in).

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