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Dear Andy

**Consultation on supplementary information and analysis to November 2018
minded-to decision on the Targeted Charging Review**

Thank you for the opportunity to respond to Ofgem's consultation on supplementary information and analysis relating to its Targeted Charging Review (TCR) minded to decision and draft impact assessment.

We have provided comments in Annex 1 on the four matters covered by Ofgem's letter of 17 June (CM sensitivity analysis, Balancing Services Task Force findings, updated system costs and Line Loss Factor Classes). More generally, we would like to highlight the following points in respect of the TCR.

Ofgem's role in promoting sustainability

We welcome Ofgem's recent acknowledgement, following on from the Government's Net Zero commitments, that although policy decisions relating to decarbonisation have traditionally been made by the Government, Ofgem has an important role in the way it regulates the energy market in minimising the costs of the low-carbon transition; and that Ofgem's role in assessing the trade-off between current and future consumers' interests – between cheaper prices now and more sustainability – will come into greater prominence.¹

In the same context, Ofgem notes that its TCR assessment calculated the impact on sustainability of proposed changes to the allocation of fixed network costs and found them to have a positive effect. As far as we are aware, Ofgem's TCR minded-to position and draft impact assessment does not assess sustainability *per se*, but we assume this comment is referring to the finding that there would be a net decrease in carbon emissions (and reduction in system costs) due to the residual charging reforms element of TCR.²

¹ [Martin Cave's speech at Utility Week Energy Summit 2019](#)

² 'Targeted charging review: minded to decision and draft impact assessment', Ofgem, 28 November 2018, para 5.35

Clearly, the same cannot be said of the TGR/BSUoS reforms element, which Ofgem has found will cause a significant *increase* in carbon emissions and potentially make the overall system more expensive (and less sustainable) - even before the impact on renewables deployment is considered. Given the Government's new Net Zero target and Ofgem's duties in respect of sustainability, we think it is particularly important that Ofgem assesses properly the impact of the TGR/BSUoS reforms on decarbonisation, including the impact on renewables deployment.

Explanation of why consumer benefit trumps system benefits

On the basis of Ofgem's revised modelling, embedded benefits reforms (TGR and 'full BSUoS') are estimated to lead to a £0.33bn *increase* in system costs under the Community Renewables scenario - which in light of the Government's recent 'Net Zero' commitments, should be given greater weight than the Steady Progression scenario, as it achieves a greater degree of decarbonisation. Furthermore, additional sensitivity calculations performed by Oxera suggest the increase could be as high as £0.88bn – all this before the impact on renewable deployment is taken into account.

We therefore consider Ofgem should provide a more reasoned explanation of why it is appropriate to implement a package of embedded benefit reforms which significantly decreases overall system efficiency and overall GB welfare. It is not sufficient simply to argue that a reduction in system benefits (a more comprehensive measure of welfare) is trumped by an increase in a narrower measure of consumer benefit (which, for example, takes no account of consumers' interests in reducing carbon emissions). Nor is it appropriate to argue that in combination with the residual charging reforms, the overall system cost impact is favourable. If the reform packages are separable (which they are), each should be considered on its merits.

Finally, we would note that, the high consumer benefit figures are themselves in doubt, with Oxera estimating that the benefits could be reduced by up to £1.3bn or £7.6bn (depending on the scenario) when the impact of the reforms on renewables deployment is taken into account.

Modelling of impact on renewables deployment

We welcome the confirmation in Ofgem's open letter of 21 May that it intends to conduct further analysis on the implications of embedded benefits reform for the deployment of renewables (windfarms and solar PV). As we have previously explained, we think that modelling the impact on renewables deployment (and the cost of mitigating any reduction in onshore deployment) is an important and complex task which could have significant implications for Ofgem's assessment of the correct way forward. We therefore believe that, as a matter of good regulatory practice, Ofgem should consult on the results of this new modelling work, in the same way that it is now consulting on the results of its CM sensitivity modelling.

However, if our understanding of the 21 May letter is correct, Ofgem's current intention is to publish the results of this new modelling alongside a final decision and final impact assessment, without affording industry an opportunity to critique or challenge the assumptions and approach. Given that Ofgem has now ruled out the April 2020 option for implementing the embedded benefits reforms, it seems to us that it should be possible to fit in a consultation on the renewables modelling work without impacting the timetable; and even if not, we believe it would be worth incurring a delay to ensure that the overall process is robust.

If this revised modelling shows the impacts we expect, Ofgem should explore with BEIS, the Scottish Government and other stakeholders how the package of BSUoS and other changes can be implemented in a way that does not jeopardise the critical role of renewables in meeting the UK's legally binding carbon reduction targets.

TGR reforms

Given the magnitude of the TGR impact on transmission-connected windfarms, it is vital that the process for revising the calculation of TGR in light of Ofgem's decision on CMP261, which is the subject of CUSC modification proposal CMP317, is subject to full industry review and consultation. CMP317 ('Identification and exclusion of Assets Required for Connection when setting Generator TNUoS charges') commenced with a workgroup meeting on 27 June where it was evident that this area is one of significant complexity that will require an appropriate time period to create a sustainable solution.

Yours sincerely,



Richard Sweet
Head of Regulatory Policy

**TARGETED CHARGING REVIEW: MINDED TO DECISION AND DRAFT IMPACT
ASSESSMENT – SCOTTISHPOWER RESPONSE**

1. Introduction

Ofgem's consultation letter of 17 June provides an update on four matters:

- a new sensitivity analysis relating to suspension of the Capacity Market;
- the Balancing Services Charges Task Force findings;
- updated system costs due to corrected carbon appraisal accounting;
- clarification on the use of Line Loss Factor Classes in our minded to proposal.

Our comments on these are set out below.

2. Capacity Market sensitivity analysis

Our understanding is that BEIS considers it very likely that the European Commission will confirm state aid approval for the CM later this year, and the chances that there will be no CM in place in future years are remote. Accordingly, we agree that it is not appropriate at present to model the impact of the no-CM scenario in as much detail as the more likely scenario covered in Ofgem's November IA.

However, should the position change such that there is a significant likelihood of an energy-only market in future, we believe Ofgem should carry out a more thorough assessment of this scenario, including:

- repeating the analysis for the Community Renewables scenario as well as Steady Progression - noting that the Community Renewables scenario is likely to be more representative than Steady Progression of the level of decarbonisation required to meet the Government's Net Zero commitments;
- presenting separately the results for residual reform and embedded benefits reform (in the same way as was done for the November 2018 assessment);
- an assessment of the impact on renewables deployment (in the same way as we understand is currently being done for the main CM scenario).

Separating the results for residual reform and embedded benefits reform will be particularly important given the lower overall system savings in this sensitivity analysis. As noted in Ofgem's letter:

"The results also show positive system benefits, however these are lower than in the original modelling published alongside our minded-to decision. The system benefits are reduced because of the higher Expected Energy Unserved (EEU) (net present value of system benefits projected at £0.23bn compared to £1.04bn with the Capacity Market in place)."

If, as seems likely, the increase in EEU is driven mainly by the embedded benefits reforms, this could result in an even more negative system impact for this aspect of the reforms (on top of Ofgem's most recent reduction in system benefits estimates). As noted in section 4

below, Ofgem would need to provide a more reasoned explanation of why it is appropriate to implement reforms which significantly decrease overall system efficiency and GB welfare.

3. The Balancing Services Charges Task Force findings

We agree with the Balancing Services Charges Task Force's conclusion that *'It is not feasible to charge any of the components of BSUoS in a more cost-reflective and forward-looking manner that would effectively influence user behaviour. Therefore, the costs within BSUoS should all be treated on a cost-recovery basis.'*

Ofgem has previously indicated that if the Task Force concluded that BSUoS should be treated as a cost-recovery charge, it would consider changing the charging arrangements so that BSUoS is levied entirely on demand, rather than being split between generation and demand as at present. This would be consistent with Ofgem's minded-to position on residual TNUoS and DUoS charges, which it is also planning to levy 100% on demand.

As we have previously highlighted, we believe Ofgem should be paying particular attention to the impacts of its reforms on decarbonisation targets – especially in light of the Government's recent Net Zero legislation. In this context we would note that:

- For embedded renewables generators, imposing BSUoS on demand could either be negative or neutral. If Ofgem adopts its 'partial BSUoS reform' option, the incremental effect of moving BSUoS to demand would be negative, since generators would see a reduction in wholesale market revenue with no matching reduction in costs. (We assume wholesale prices would fall by an amount equal to the BSUoS charges now avoided by the marginal generator.) If Ofgem adopts its 'full BSUoS reform' option the impact would be expected to be neutral since the reduction in revenue would be balanced by a reduction in costs.
- For transmission-connected renewables, both RO and CfD-supported, imposing BSUoS on demand would be expected to be neutral.

As noted above, we believe Ofgem should take explicit account of the impact on renewables deployment of any decision it takes on reform of BSUoS charging.

4. Updated system costs due to corrected carbon appraisal accounting

We are pleased that Ofgem has acknowledged the issue highlighted in Oxera's critique of the November consultation on the use of carbon costs, and note that Ofgem's revised system cost figures align with Oxera's estimates.³ We have summarised Ofgem's revised figures in the table below, alongside Oxera's additional sensitivity analysis.

FES Scenario	TGR & Full BSUoS reform		
	System cost increase (NPV, £bn)		Consumer cost increase (NPV, £bn)
	Ofgem	Oxera*	Ofgem
Steady Progression	-0.02	0.17	-4.52
Community Renewables	0.33	0.88	-5.99

* Oxera's sensitivity analysis considers the effect of plausible alternative values for carbon emission intensities, cost of carbon and gas prices.

³ ['Ofgem's Targeted Charging Review Impact Assessment', A review by Oxera prepared for Innogy, RES, ScottishPower and Vattenfall, 26 April 2019](#)

Of the four NG FES scenarios, two (including Community Renewables) assume that the Government's previous carbon targets (an 80% reduction of emissions by 2050 on 1990 levels) are met and two (including Steady Progression) assume they are not met. This suggests that, of these two scenarios, the Community Renewables scenario is likely to be more representative of the changes required to meet the Government's new Net Zero commitments than Steady Progression. Accordingly, we think Ofgem should be giving greater weight to Community Renewables than to Steady Progression – contrary to the impression given by its 'Baseline' and 'Alt Future Energy Scenario' descriptors of the two scenarios.

In light of the above, with a potential £0.33bn - £0.88bn increase in system costs under the Community Renewables scenario, we consider Ofgem needs to provide a more reasoned explanation of why it is appropriate to implement a package of embedded benefit reforms which significantly decreases overall system efficiency and overall GB welfare. It is not sufficient simply to argue that a reduction in system benefits (a more comprehensive measure of welfare) is trumped by an increase in a narrower measure of consumer benefit (which, for example, takes no account of consumers' interests in reducing carbon emissions). Nor is it appropriate to argue that in combination with the residual charging reforms, the overall system cost impact is positive. If the reform packages are separable (which they are), each should be considered on its merits.

5. Use of Line Loss Factor Classes

Ofgem's letter of 17 June clarifies that when it proposes to use line loss factor class (LLFCs) to segment users for the purpose of its preferred residual charging option, it intends to use LLFC groupings aligned with the industry-wide Distribution Use of System (DUoS) tariff groups, noting that there are distinct processes to update LLFCs and DUoS tariffs. Ofgem's clarification largely addresses the practical concerns over use of LLFCs highlighted in our response to the November consultation.

ScottishPower
July 2019