



**Consumer
Focus**
Campaigning for a fair deal

Consumer Focus response to Ofgem consultation on Project TransmiT (Electricity transmission charging: assessment of options for change)

February 2012

About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses, public services and policy makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers, and aims to give people a stronger voice. We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

General commentary

The Ofgem consultation document: *Electricity transmission charging: assessment of options for change* represents a timely examination of the fitness for purpose of the current transmission network (TN) charging regime. It is vital the ultimate choice of TN charging mechanism for the UK complements the delivery of the UK's strategic energy goals: sustainability, security of supply and affordability.

We support the dismissal of the socialised or postage stamp model for TN charging.

The Redpoint modelling (RM) suggests the removal of the locational signal from TN charging would lead to inefficient TN development. The RM suggests this would increase consumer bills by almost £6.9 billion¹, when compared to the status quo, with little consumer benefit in terms of security of supply or sustainability.

However, based on the evidence presented in the consultation document, we cannot support Ofgem's initial view that improved Investment Cost Related Pricing (ICRP) is the right direction of travel for transmission charges. Rather the evidence presented supports the retention of the status quo.

Compared to the improved ICRP model, the status quo represents:

- **Better value for money**
Improved ICRP will cost consumers almost £0.9 billion more than the status quo. Furthermore, the improved ICRP will lead to more than £1 billion in additional profits for generators, with no demonstrable consumer benefit
- **Better sustainability outcomes**
The status quo leads to the lowest carbon intensity for the energy sector by 2030² and is compatible with meeting 2020 renewable energy target
- **A viable means of ensuring security of supply**
The RM suggests all the options considered meet security of supply requirements

We accept the current ICRP model (the status quo) has inadequacies and merits a re-examination of its fitness for purpose. There appears to be a prima facie case for an improved ICRP model. For example, the capacity based approach for calculating the wider element of the current Transmission Network use of System Charges (TNUoS) tariff does not allocate costs in a reflective manner for more intermittent and dispersed generation technologies (which are likely to form an ever increasing proportion of the UK's generation portfolio). However the consultation document does not provide a compelling case for change.

We welcome Ofgem's work to date on progressing Project TransmiT, however we are disappointed there was no consumer representative in the working group. We feel that appropriate consumer representation should work in partnership with NGET, industry and Ofgem to further develop an effective ICRP model that delivers value for money, security of supply and positive sustainability outcomes for UK consumers.

¹ NPV 2012 to 2020 (at 3.5%)

² Ofgem, *Electricity transmission charging: assessment of options for change* (December 2011), Figure A5, p.61

Response to consultation questions

Chapter 4

Question 1: Do respondents consider that we have appropriately identified and where possible quantified the impacts of the Project TransmiT?

No.

Question 2: Do respondents consider there are additional impacts we should take into account in the decision making process and, if so, what are these?

Yes.

Consumer bills represent the best welfare measure

We note that the material impact of the options has been assessed against both power industry costs and consumer bills; however we are concerned with the statement in 4.33:

'Power sector costs are used as a welfare measure as they represent the change in total cost to society of meeting electricity demand. Consumer bill impacts are not an overall welfare measure, but rather the impact on just one part of society.'

The energy market exists to serve consumers' demand for electricity. It therefore seems logical that the impact on consumer bills represents the best welfare measure for Project TransmiT (and other energy sector initiatives).

We believe that using the more narrow measure of power sector costs as a welfare measure is only appropriate when there is confidence that the energy market is operating in a competitive and consumer-focused way. Otherwise there is a risk that consumers, and society at large, will see little benefit from falling power sector costs.

The [findings of Ofgem's Retail Market Review](#) suggest a number of reasons that the UK energy market is not working in the interests of consumers. It shows that lower power sector costs do not necessarily reduce consumer bills. Ofgem itself has acknowledged that there is *'some evidence that customer energy bills respond more rapidly to rising supplier costs compared with falling costs'*³. We consider that the industry track record means the use of power sector costs as a welfare measure is an inherently flawed approach.

We also find the statement in 4.52 concerning. It suggests that higher prices – and by extension more households in fuel poverty – could be in consumers' interests:

'...we note that higher prices could result in a more efficient market outcome if the more accurately reflect all the relevant costs. Whilst a suppressed price is better for consumer in the short-run, it is inefficient and may ultimately damage consumer interest in the long-run. As such we have to consider the increase in consumer bills with market efficiency in mind.'

³ Ofgem, *Do energy bills respond faster to rising costs than falling costs?* (March 2011)

No evidence is presented that the status quo would lead to a 'suppressed price'. This statement appears an attempt to explain that investment in infrastructure can deliver long term benefits to consumers, which can, of course, be true. However, the case for additional burden on consumers (and profit for regulated industries) should be explicitly addressed in an impact assessment, with a detailed cost benefit analysis. The statement in 4.52 does not provide a sufficient level of robustness to ensure both present and future consumers' interests are protected for the projected increase in consumer bills and power sector profits.

It is worth re-iterating that Ofgem's analysis suggests that the status quo would deliver secure energy supplies at lower carbon intensity than either of the modelled alternatives – this suggests that the imperatives of carbon reduction and supply security are not currently suppressed when compared with the alternatives. Indeed, noting that the modelling suggests that the status quo delivers the lowest carbon intensity, a case can be made that it is actually the alternative models that are suppressing the value that society places on these outcomes. It seems perverse to ask consumers to pay more, to get less.

Value for money for consumers

The Redpoint modelling (RM) suggests that consumer bills will rise by almost £900 million (see table below) under improved ICRP. The benefits from this additional cost to consumers are not quantified or qualified within the consultation document. Indeed, the Executive Summary states:

'...[the charging options] are all consistent with meeting the UK Government's 2020 renewable target and carbon intensity goals with no material differences in the implications for security of supply.'

Improved ICRP represents a poorer sustainability outcome for consumers – and at higher cost – compared to the status quo: it results in higher carbon intensity for the energy sector by 2030⁴.

We feel that the addition of almost £900 million to consumer bills, approximately £33 per household, between 2012 and 2020 requires more detailed and thorough justification. In particular it should be demonstrated that consumers receive a clear benefit in terms of security of supply and/or sustainability to justify the higher cost.

We conclude that there is an absence of robust justification for the projected increase in consumer bills of almost £900 million and we therefore believe improved ICRP is not in consumers' interests.

Power sector profits – where is the consumer benefit?

Paragraph 4.33 states: '...the difference between impacts on power sector costs and on consumer bills is producer surplus, which represents earning by generators and transmission owners above their long-run cost of delivering electricity (ie changes in profits in the power sector).'

It is unclear what consumer benefit derives from the additional power sector profits of over £1 billion (table below). We cannot support proposals for increased power sector profits without demonstrable evidence of consumer benefit.

⁴ Ofgem, *Electricity transmission charging: assessment of options for change* (December 2011), Figure A5, p.61

	Improved ICRP	Socialised
Total impact on power sector (source: Table 2, Ofgem con doc)	-122	2769
Total impact on consumer bills (source: Table 3, Ofgem con doc)	897	6876
Implied additional power sector profits	1019	4107

Consumer bills, generation costs and implied increase in power sector profits ('producer surplus')

(NPV 2012 to 2020 (@3.5%) £ million real, relative to status quo under stage 2 modelling)

We welcome the assessment of the regional impact of the charging options; however the impact of the options on the absolute level of fuel poverty – on both a regional and national basis – across the UK is not quantified. This is a major omission from the consultation document as this is an important criterion for assessing the relative merits of the options presented: it could easily be quantified from the available data. It seems certain that the £900 million addition to consumer bills under improved ICRP will result in more households in fuel poverty. This further underlines the need for a more robust justification for a move away from the status quo.

We question the assumption that the Generation:Demand (G:D) split should change

All options for the RM assume a shift of the G:D split from 27:73 to 15:85 in 2015.

The current TNUoS split of 23:77 between generation and demand is the legacy of an era when the development of the TN was largely demand-led. Under these circumstances, it is reasonable for demand to pay the major portion of TN costs. However, the inverse is true today: TN investment is now largely generation-led, such as the connection of remote, intermittent capacity. Indeed the desire to remove the barriers for these new types of generation to connect to the TN is the principal rationale behind Project TransmiT. Thus there a strong case for a greater proportion of TNUoS falling on generation and less on demand. This is the reverse of the direction of travel envisaged by the consultation document.

The consultation makes a strong case for the continued application of a locational element to transmission charging. The RM suggests the status quo and the improved ICRP model (both including a locational element) meet sustainability and security of supply objectives at lower cost than the socialised model (which does not include a locational element). As the RM analysis shows, a locational element on generation impacts upon the pattern of generation technology deployment. However, a locational signal has negligible impact on demand patterns: the differential is too low to motivate consumers to move home in order to reduce their electricity bills. It therefore appears contradictory to the conclusions of the consultation – which strongly supports a locational charging element – to weaken the effect of the locational signal by reducing the G component and increasing the D component.

Rationale for the G:D split change: harmonisation with continental Europe

We note in 6.17 that '[Ofgem] does not think it necessary to alter the G:D split at this stage. However NGET should keep the G:D split under review and make proposals for change as and when necessary through the normal modification process.'

We are concerned that the future direction of travel remains a shift to 15:85 (G:D).

A change in G:D split to 15:85 will lead to a shift in costs from generators to suppliers and hence more directly to consumers. The benefit/detriment to consumers from such a shift must be fully assessed. The argument that harmonisation of G:D across Europe will lead to a more competitive market and hence better outcomes for consumers needs further development and consultation.

The charging regime across Europe is far from homogenous. Indeed, for many member states, the charging regime lacks transparency. Under these circumstances it is difficult to assess what constitutes harmonisation; there is sufficient degree of ambiguity to justify a range of possibilities. It would also make any enforcement action by the Commission difficult. There is a risk of the UK 'gold plating' EU guidelines to the detriment of the consumer.

The impetus for the shift in TNUoS burden to demand has been attributed to a desire to harmonise with EU Tariffication Guidelines. We feel the pressure to comply with these guidelines is complex and not clear cut. For example, the guidelines could be interpreted as excluding the local substation and local circuit elements of TNUoS which represent approximately 7 per cent of the revenue NGET collect under TNUoS.

The EU Tariffication Guidelines arising from the Regulation on Cross Border Electricity Exchanges state:

'The value of the "annual national average G" is annual total transmission charges paid by generators divided by the total measured energy injected annually by generators to the transmission network.'

The Regulation also states: *'Annual average G shall exclude any charges paid by generators for physical assets required for the generators connection to the system (or upgrade of the connection) as well as any charges paid by generators related to ancillary services or any specific network loss charges paid by generators'*.

We would welcome further clarification and independent analysis of the rationale for change, an assessment of when any change might occur, and detailed assessment of the materiality. Not only would this assist in assessing the impact on consumers, but it would help to increase investor certainty within the power sector. This should result in a lower cost of capital, from which consumers should derive some benefit.

Judging any changes to the G:D split on their merits

The demand component of TNUoS presents a more predictable component of TNUoS compared to generation. This is because consumers are relatively immobile, with predictable patterns of demand, whereas generation is more variable. It therefore seems entirely plausible that a risk averse network operator might wish seek to increase the proportion of TNUoS gathered from demand. We also recognise that the lopsided nature of energy stakeholder representation – eg the dominance of producer over consumer interests on the Connection and Use of System Code (CUSC) – may make it markedly easier for industry to progress proposals that seek to alter the G:D split in the favour of producers rather than consumers. These natural biases make it vitally important that Ofgem effectively scrutinises any future proposal to alter the G:D split.

Assess the materiality of the potential windfall gains, especially for generators north of the border

The improved ICRP will result in windfalls (both gains and losses) for several generating plant. It is likely the impact will be felt unevenly by generators; those with more northerly generating plant in their portfolio will benefit more than those with more plant in the south east, for example. We feel it is important to assess the order of materiality of these windfalls on the major generating companies so there can be due consideration of any competitive advantage that may accrue to generating companies from TransmiT. Given the uncertainties of future energy deployment, we suggest that this would most simply be achieved by considering windfalls against *current* patterns of generation rather than extrapolating out until 2020 or 2030.

Question 3: Do respondents consider that we have appropriately identified the potential interactions of the Project TransmiT options?

No comment.

Question 4: Do respondents consider that we have appropriately identified the likely impacts or consequences of these interactions?

No comment.

Chapter 5

Question 1: Do respondents consider that we have appropriately identified and taken account of the key sustainability issues?

No.

While all models suggest that the 2020 renewable energy target will be met, the precise energy mix, and hence the average carbon intensity of the UK energy sector, varies between the options. Figure A5 on page 61 suggests the status quo will deliver the lowest carbon intensity. Thus according to the RM, the status quo offers the option with the greatest sustainability benefits. The status quo also results in lower – although unquantified – transmission losses than improved ICRP, an additional sustainability benefit.

The Committee on Climate Change (CCC) is an independent body established under the Climate Change Act to advise the Government on emissions targets, and to report to Parliament on progress made in reducing greenhouse gas emissions. It might be helpful to assess the impact on the likelihood of meeting the CCC's recommendations for the energy sector contained within the CCC's carbon budgets. Specifically the CCC analysis that suggests the need for investment in 30-40 GW of low-carbon capacity in the decade from 2020 and average emissions from generation down to around 50 gCO₂ /kWh by 2030. It should be noted that none of the options proposed allow average emissions from generation to fall to this level: carbon intensity is predicted to be almost double at approximately 100gCO₂/kWh by 2030.

Ensure wind is not constrained off in preference for higher carbon generation

None of the options will ensure that wind is not constrained off the network. Given that winds, and other renewables, are a lower carbon source of electricity than fossil and nuclear, they should always be given network preference to ensure the UK's electricity is delivered at the lowest possible carbon intensity and that the relatively expensive fixed assets for renewables are efficiently exploited.

Other possible sustainability impacts

Improved ICRP could disincentivise the use of onsite battery storage at wind farms (if it enabled wind farms to operate at baseload). Onsite batteries could provide an effective mechanism for managing intermittent output.

Improved ICRP does not distinguish between the very different output properties of renewable energy resource. Tidal, for example, had a much more predictable, long term output than wind. We would hope that these differences would be explored further.

Question 2: Do you think there may be long term and strategic benefits associated with the development of HVDC technology, in particular the treatment of convertor station costs for links that parallel AC network, which Project TransmiT modelling has not fully considered because of the timeframe of the modelling (ie 2030) and the limited nature of the bootstrap option?

We would welcome a detailed cost benefit analysis and an assessment of the likely impact upon consumer bills from the deployment of HVDC.

Question 3: Do you have any supporting evidence for a different treatment of the converter station costs for the planned bootstrap HVDC options?

No.



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