Your update on energy news and regulation

March 2018

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General retail updates for all businesses

Changes to the Smart Meter Rollout programme

Under this scheme, all gas and electricity meters need to be upgraded, to be a smart meter or Automated Meter Reader (AMR) meter by 2020. This will help consumers control energy usage, and enable a more efficient, greener, smarter energy system.

Business energy suppliers must make efforts to install smart meters at all SME sites by the end of 2020. There is an exception called the ‘AMR exemption’. This means that, up to the ‘exemption deadline’, an AMR device can be installed and count towards the 2020 target. The exemption deadline was recently extended by the Department for Business, Energy, Industrial Strategy (BEIS) to 5 October 2018. You can read the decision letter here.

As well as extending the AMR exemption, since the election, BEIS has also published a policy proposal to provide more flexibility for the rollout programme to non-domestic customers.

Large group customers (portfolio customers with an aggregate demand of more than 3GWh in either gas or electricity) will only need to have AMR devices installed. If a customer is eligible in one fuel, they will automatically be eligible for both fuels. This would not be subject to a time-limited exemption, but would be an enduring feature of the regime (for example, the AMR devices would not have to be replaced after 2020). The BEIS consultation on this proposal closed in October and a response is expected imminently. You can read the consultation document here.

Dieter Helm's independent review on the cost of energy

As part of its election manifesto, the Conservative Party commissioned an independent report into the GB energy market and the cost of energy. The report was written and published by Dieter Helm, Professor of Energy Policy at the University of Oxford. The report looked at how to reduce costs in the electricity system in the long-term, whilst making sure that the UK meets its climate change target. The review asserts that the cost of energy is higher than is needed to meet the Climate Change Act target (80% reduction in carbon emissions by 2050). Though it accepts that offshore wind prices have fallen under the current regime, Professor Helm asserts that prices have been kept higher by continual government intervention and that a unified Equivalent Firm Power (EFP) capacity auction should be implemented covering all technologies. In addition, it proposes a greater role for Distribution Network Operators (DNOs), becoming regional system operators who are required to ensure local security of supply by contracting with generation and Demand Side Response (DSR).

The Government has accepted the report, but hasn’t committed to any of the recommendations yet. BEIS and the Government generally have not backed the report or its findings, indicating a lack of strong support. It has also received a lot of scrutiny from the BEIS select committee, who has commented that it was too theoretical and didn’t take account of the successes of current programmes, such as the cost reductions in offshore wind delivered in recent CfD auctions (see associated article on green levies below). In addition, the select committee was sceptical of the practicality and efficiency of the EFP with generators and Demand Side Response (DSR) suppliers providing back-up for intermittent generators via bilateral auctions. You can read the full report here.

Brexit: energy security report published

The Lord's EU Energy and Environment Sub-Committee has published its report on the implications of Brexit on Energy Security. The report states that a lack of clarity around Brexit creates risks for trade in energy with the EU and the subsequent management of any potential supply shortages.

The Committee notes that the UK's ability to build nuclear generation in the future may be put at risk if access to specialist EU workers is reduced. Failure to replace the provisions of the Euratom Treaty could result in the UK being unable to import nuclear materials.

The report concludes that, post-Brexit, the UK may be more vulnerable to energy shortages in the event of extreme weather or unplanned generation outages, and asks the Government to set out how it will work with the EU to anticipate and manage these conditions. You can read the report here.

Ofgem's faster switching programme

Ofgem's outline business case has been published recently, marking the next major milestone in its faster switching project. If the customer requests to switch to a new supplier or contract before 5pm on a working day, the switch must be made by midnight the following working day. If the customer changes their mind during this period, they can request to switch back to the original contract, stay with the new suppliers on a new contract, or move to another supplier. For non-domestic customers, the existing contractual frameworks will still apply, but if the customer is out of contract, the switch will be completed within 2 working days. The licence obligation on suppliers will be five working days for all customers, to give time for the market to move to the shortened timescales.

To achieve this, system changes will be significant, and this won't be in place until 2019. Changes will include the creation of the Retail Energy Code, along with the appointment of a new Centralised Switching Service provider. For the rest of 2018, the focus will be on drafting the new licence requirements and appointing the new service providers. You can read more information here.

Electricity updates for all businesses

CMP 264/265: judicial review on charging arrangements to embedded generators

Ofgem's view is that small scale generators connected to the distribution network enjoy significant benefits under the transmission charging framework, compared to generators connected to the transmission network. Ofgem's view is also that these benefits distorted the market, so it approved two recent changes to the market eliminating the embedded benefits. A group of smaller generators have made a formal application for a judicial review on Ofgem's decision, on the basis that if this change is made, payments to small-scale generation sites that are connected to the distribution network will be lower, directly impacting the financial viability of generators which have made embedded benefits a key element of their business case.

The changes are still due to be implemented on 1 April 2018, through two Connection and Use of System Code (CUSC) changes to the industry, CMP264 and CMP265. This is after an application to suspend the decision was rejected by the court; a decision that Ofgem has stated has benefitted customers in the region of £500m. Through these changes, Transmission Network Use of System (TNUoS) demand residual payments to distribution network connected generators will be significantly reduced.

The judicial review can either uphold Ofgem's original decision or quash it. If it's quashed, changes will have to be reversed out, possibly with some form of retrospective adjustment to cover the period where the 'wrong' charging regime was applied. This could result in significant charge volatility over the next couple of years for customers, particularly those on pass-through contracts.

We expect that there will be an initial decision on the judicial review by the end of the summer. You can read Ofgem's latest communication on the judicial review here.

Competition Markets Authority (CMA) rejects generators appeal of Ofgem's decision not to refund transmission charges overpayment

The CMA has rejected SSE and EDF Energy's appeal of Ofgem's decision to reject a proposal (CMP261) for National Grid to refund £120m in transmission charges. EU law limits the average generation charges that can be levied on generators to no more than €2.50/MWh. Some organisations believed that National Grid breached this limit in 2015/16, owing to a misinterpretation by them of what could be included in a transmission charge, and so raised a change for that money to be returned. This would have meant that customers would have to pay the rebate to the affected generators (though there was proposed two-year time lag). Ofgem disagreed with the view that generators had been overcharged and rejected the change. The CMA agreed with Ofgem's interpretation. You can read the decision on the appeal here.

National Grid announces new plan for balancing services

National Grid has announced that it needs to develop new mechanisms to balance the system in the future as the amount of intermittent and small-scale generation in the market increases. The aim is to create a 'marketplace for balancing that encourages new and existing providers, and all new technology types'. National Grid has a four-point plan to achieve this new market:

1. Improve the information they share with parties/investors on future system needs
2. Simplify the balancing services
3. Remove barriers to make better use of localised energy resources; and
4. Improve other market mechanisms, such as reviewing who can directly access the balancing market.

In October 2017, National Grid announced its plans to simplify both Frequency Response and Reserve product suites. The rationale was to remove barriers to entry for new participants and technologies.

In practice, this means that five products will be phased out: **Firm Frequency Response Bridging, Frequency Control by Demand Management, Enhanced Frequency Response, Short Term Operating Reserve (STOR) Runway and Enhanced Optional STOR**. While National Grid will no longer procure these services, existing contracts have not been cancelled, meaning that those businesses with contracts in place will continue to deliver capacity on the agreed basis.

Frequency Response standard contract terms are currently being simplified, with consultation on the new terms taking place during Q1 2018. Again, the intention is to remove complexity, making participation an option for a larger number of companies.

As part of the new, simplified product set, National Grid is seeking to address two key concerns identified with each scheme. For STOR, two products will be created with different criteria for initiation speed; one requiring less than 20 minutes to respond, one with a longer response time. For Fast Reserve, contract terms are being revised, enabling greater flexibility. Participants can tender for contracts from one month up to ten years, depending on their business preferences. You can see a the National Grid Balancing Product Roadmap here.

Green levies - control for low carbon levies framework announced

Following the announcement in the Spring Budget to end the Levy Control Framework (LCF), the Government has published its new proposed Control for Low Carbon Levies (CLCL). The main difference between the two controls is that the LCF didn't consider that a significant level of green costs come from signed contractual obligations (such as the Capacity Mechanism). It was also announced within the CLCL that there will be no new levies until 2025, at the earliest. The forecast below appears in the report appears in the report 'Control for Low Carbon Levies , which can be viewed here

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Renewables Obligation	3.9	4.6	5.0	5.1	5.1	5.1	5.0	5.0	4.9
Feed-in Tariff	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Contracts for Difference	0.1	0.6	1.1	1.6	2.1	2.3	2.4	2.5	2.5
Total	5.2	6.4	7.3	7.9	8.4	8.6	8.6	8.7	8.6

Source: Department for Business, Energy and Industrial Strategy

Green levies - Capacity Market

The Capacity Mechanism is continuing to develop and there have been a number of changes to processes. Now, supplier liabilities won't be determined with reference to embedded generation (so it doesn't reduce total demand) and this has shifted costs between suppliers. Also, the latest Capacity Auctions results have been announced. The total quantity of De-Rated Capacity bought was 5782.892 MW at T-1 (so with one year's delivery notice), with the final clearing price £6/kW/yr. The capacity from this auction has the same delivery year as the first T-4 auction held in 2014. You can read the final results report here. The T-4 final results were also published, with 50.4GW of de-rated capacity procured for £8.40/kW/yr. You can read the final results report here.

Green levies - latest CfD round results

BEIS published its latest CfD results in September 2017. 11 projects were awarded 15-year contracts across a range of less established technologies.

The headlines were:

- 3.2GW of offshore wind capacity awarded contracts with 2,340MW at £57.50MWh and 860MW at £74.25 MWh (to reflect earlier delivery year);
- Offshore wind clearing prices are half the levels awarded two years ago in the CfD round 1 and significantly below the £92.50MWh levels awarded for 35 years to EDF for Hinkley C;
- Dedicated Biomass and Advanced Conversion Technologies (ACT) won 149.95MW, of which Grangemouth Renewable Energy Ltd accounted for 85MW at £74.75 MWh;
- Dependent on the biomass content of the fuel and assuming 50%, Advanced Conversion Technologies (ACT) sites will receive £37.37MWh; and
- The cost, which Suppliers will pick-up, will be £21,724,242.99 in 2021/22 rising to £148,538,708.02 by 2024/25.

You can read the full details of the auction here.

Green levies - Targeted Charging Review

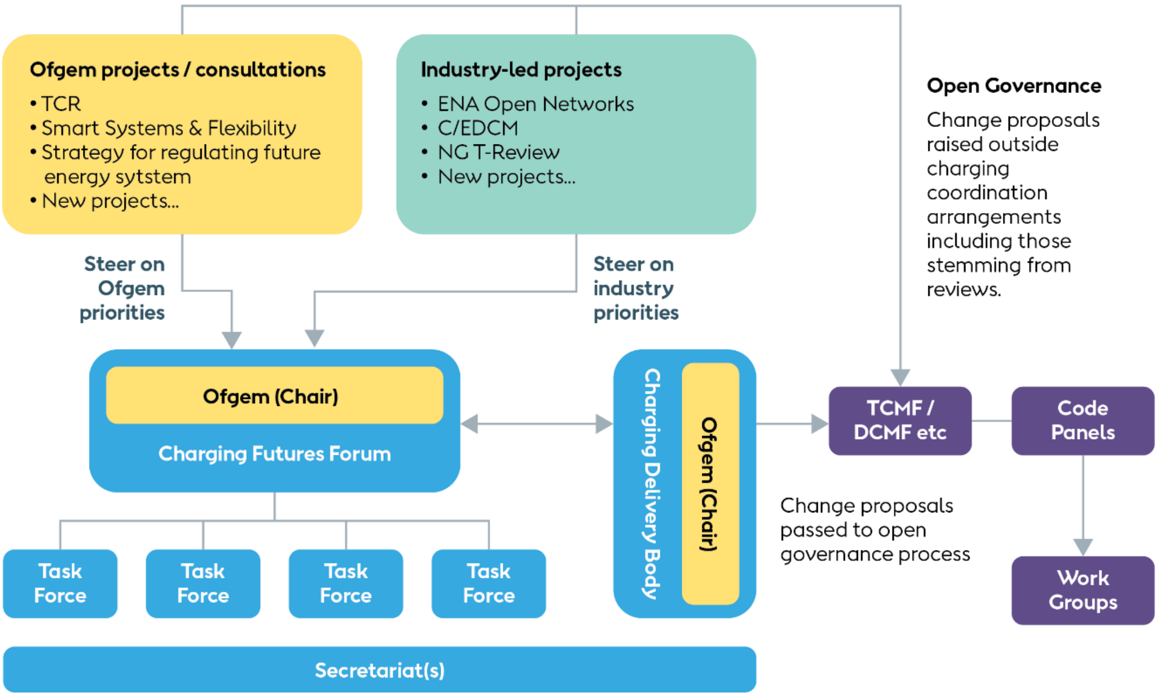
Ofgem has formally launched a review (termed a Significant Code Review) into charging. The objectives are:

- To consider reform of residual charging for transmission and distribution, for both generation and demand, to ensure it meets the interests of consumers, both now and in future.

- To keep the other 'embedded benefits' that may be distorting investment or dispatch decisions under review (see judicial review statement above).

The likely impact of this review is that network charges will be rebased for some or all customer types (small generators, etc), but it's too early to tell whether this will result in additional costs or savings for customers. Ofgem has also published a paper on residual charges, which sets out its view that these are currently unfairly allocated across the market. The targeted charging review document can be found here.

Ofgem's review structure is below. This appears in Appendix 1 'Launch of Charging Futures Forum' which can be viewed here.



The review will not look at storage issues. The below table shows 'network users' current exposure to residual cost/recovery charges', which appears in Ofgem's Targeted Charging Review. To read the full review, click here.

	T Generation	T Final Demand	T Storage†	D Smaller EG*	D Larger EG**	D Smaller Storage*†	D Larger Storage**†	D Final Demand
Transmission residual	✓		✓		✓		✓	
		✓	✓	Paid††		Paid††	✓	✓
Distribution residual				Only EHV pay.#	Only EHV pay.#	Only EHV pay.#	Only EHV pay.#	
					✓	✓	✓	✓
Balancing	✓		✓		✓		✓	
		✓	✓	Paid		Paid	✓	✓

✓ - Pay the charge   Paid - can get the paid inverse of the charge
* <100MW   ** >100MW
† May be affected by ongoing storage modifications CMP280 & CMP281
†† Will be replaced by dedicated embedded export tariff following CMP264/5 WACM4 implementation
# Only those connected at EHV level pay distribution demand residuals. All others are exempt

Green levies - CMA - introduction of Zonal Transmission Losses

As part of its investigation into the energy market, CMA concluded that the absence of locational pricing for transmission losses has an adverse effect on competition. As a result, from 1 April 2018 there will be seasonal Transmission Loss Factors (TLF) for each electricity region (termed Grid Supply Point or GSP Group) to allocate transmission losses on a geographical basis. The intent is that this proposal will provide locational signals to generators and will drive more efficient dispatch of plant, but any savings or costs to consumers will be dependent on where they are located. The biggest impact will on those customers who are located a long way from generation, paying more for the energy to be delivered to them, and those located close to large amounts of generation, who will see their costs drop. The solution that implemented this change (P350) can be found here.

General retail updates for SME business

Ofgem's State of the Market report

Ofgem has produced its first annual State of the Market Report, which gives an overview of the health of the market. We've summarised the main points here:

- Competition continues to benefit household consumers who are able and willing to shop around, meaning they can usually get a good deal. However, this isn't working well for consumers who are less active. Around 60% are on a default variable tariff, which can be around £300 more expensive each year than the cheapest fixed-term deals.

- Retail markets typically work well for larger businesses who can often negotiate good deals with suppliers. Small and microbusinesses pay much more on average, and switch infrequently. Average business electricity prices are around 50% higher for very small firms than for large or very large consumers.

We expect that this summary will have an impact on Ofgem policy for the next year or two. You can read the full report here.

Queen's Speech and Budget 2017

There were a few public policy commitments from the Queen's Speech that impact non-domestic energy customers:

- A commitment to supporting initiatives that will improve switching and transparency in the market (i.e. Ofgem's Faster and More Reliable Switching project, which seeks to shorten switching timescales for domestic customers).
- Special Administration Regime – this has been proposed to ensure the continuing operation of the national smart meter service if the provider becomes insolvent. This is part of a Smart Meters Bill which is currently progressing through Parliament. The Data Communications Company (DCC) is currently Capita.
- A proposal that suppliers will be required to 'offer' a smart meter rather than 'install' a smart meter.
- A bill to strengthen the oversight of sales of 'critical national infrastructure'. This will ensure foreign ownership doesn't undermine security or essential services. A consultation on this issue recently concluded and formal proposals are likely to be raised at some point this year.

The Budget also had relatively modest proposals. On the Climate Change Levy (CCL), there will be a rebalancing of the main rates for electricity and gas and there will also be changes to the exemptions for landlord-tenant situations. CCL main rates for the years 2020-21 and 2021-22 will be set in Budget 2018. There will also be a list of designated energy-saving technologies qualifying for an Enhanced Capital Allowance (ECA). The tax exemption for energy-efficient technologies for the first tax year is increasing to two-thirds the rate of corporation tax. You can read the main documents on the Queen's Speech here and the Budget 2017 here.

Electricity updates for SME businesses

Half-hourly settlement update

Ofgem is currently undertaking a project to move all electricity customer premises to be settled on a half-hourly basis, and in November published its latest thinking on the proposals. There's currently a lot of detail on the solution to be developed and this is being progressed by Elexon, the electricity settlements administrator. This is a long-term project that will take a significant time to develop. The solution won't be agreed upon until the end of 2019 and deployment isn't expected until sometimes after 2020. The next major milestone will be the delivery of the draft solution. You can read the full business case here.

General retail updates for I&C businesses

Industrial strategy white paper

The Government's industrial strategy white paper contains a small section explaining plans to reduce industrial energy costs. The goal is to enable business and industry to improve energy efficiency by at least 20% by 2030.

- In the short-term, the Government has moved away from compensating eligible Energy Intensive Industries (EII) for the cumulative costs of energy and climate policies, to a system of exemption from Contracts for Difference (CfD) and Renewable Obligation (RO). These exemptions are starting during 2018. However, state aid considerations for the Feed-in Tariff (FiT) scheme will take longer to resolve, so, in the meantime current compensation will remain in place.

- The Government also plans to consult on widening eligibility for the exemption schemes for EII's. This will help address potential intra-sectoral competitive distortions. The consultation hasn't been published yet.

- A new scheme will be developed to support investment in industrial energy efficiency. This will help large businesses cut their energy use and bills, and improve their productivity.

- Businesses will be supported to further improve their energy productivity, and this will be put out to consultation in 2018.

You can read the industrial strategy white paper here.

Gas updates for I&C businesses

I&C Gas Quality Consultation

The Institution of Gas Engineers and Managers (IGEM) is working on a new standard covering UK gas quality specifications, in light of the availability of alternative sources of gas and to align with the European standard. The proposed standard will set a Wobbe Index (WI) range that's appropriate for the UK, initially examining the extension of the upper range. This review will also look at industrial and commercial equipment greater than 1 MW, to assess if they may be affected by the change in gas quality. The consultation ended on 13 December 2017 and can be found here. The results of the consultation will be shared at some point in 2018.