Second consultation on the EHV Distribution Charging Methodology (EDCM): Response from the Energy Intensive Users Group

The Energy Intensive Users Group (EIUG) is an umbrella organisation that represents the interests of intensive industrial energy consumers and campaigns for secure, internationally competitive energy supplies. The intensive manufacturing sector has a critical role to play in a rebalanced UK economy; intensive industries in the UK directly employ 225,000 workers and contribute over £15 billion to UK GDP. To provide a strong foundation on which to rebuild our economy, it is vital that the UK remains a good place for intensive manufacturing to do business. Unfortunately, the EDCM charging structure still has the potential to undermine the competitive position of a number of UK intensive manufacturing businesses both in the short and longer term.

EDCM Charges in the Context of DNO's Allowed Revenue

It should be noted that the businesses that EIUG represents are frequently work to achieve real rates of return that are often materially lower than the 6.9% real rates of return guaranteed for the DNOs.

Characteristics of EHV Demand

The model is predicated on the premise that all demand is intrinsically volatile. The majority of energy intensive industries within EHV provide consistent, stable baseload demand. Whilst demand does not offset the need for generation led reinforcement altogether, it should be noted that all demand is not intermittent or volatile, especially EHV demand.

Cost Reflectivity

The stated objective of implementing these changes is to make charges more cost reflective and encourage existing and new users of the electricity distribution networks to use network capacity more efficiently, avoiding inefficient network reinforcement. Whilst sending locational signals specifically for <u>new</u> generation or demand connecting on to the network may be regarded as rational and sensible, the majority of EHV energy intensive businesses within the EIUG have very substantial capital assets and are simply not able to relocate to respond to any cost signal emitted by the proposed change to a charging structure.

For these businesses, the regime simply has the potential to increase costs, introduce volatility and damage their ability to compete. For those businesses that are able to make changes to use network capacity more efficiently, the timeframes for implementation of the new charging structure do not give them sufficient time to make the requisite investment.

High Element of Scaling

It is hard to accept that the system is genuinely 'cost reflective' when such a substantial a proportion of arbitrary 'scaling' remains inherent within the charging structure. A small portion of scaling (less than 5%) is understandable. Across the DNOs generally (and within individual businesses bill specifically), scaling remains disproportionate. The high proportion of demand scaling is indicative of a system within which too large a proportion of CDCM and EDCM revenue is potentially being allocated to EDCM users.

Volatility

Distribution Charges for EHV customers have been unacceptably volatile across the five year price controls. In June 2010, we raised concerns that the system fails to give any long term price certainty for intensive industry and will be inherently volatile, not allowing businesses sufficient price stability to enable them to plan for the future. This is a critical element that needs to be clarified for intensive industry. EIUG members remain disappointed that, at this late stage, they have no certainty about the level of volatility to which they will be subjected.

The very large swings in potential charges are very damaging to customer confidence in the system and what can actually be deemed to constitute 'cost reflective charging'.

Addressing the Impact of the Proposals on Intensive Industry

A number of EIUG members remain extremely concerned about the impact of these proposals upon the businesses within their sectors. It is evident that a substantial number of outliers remain, and for these it will be critical that action is taken to mitigate the potentially catastrophic effect of these proposals on their international competitiveness.

We believe the overall model remains fundamentally flawed if applied to all EHV customers, but if Ofgem is intent on driving through this particular change, it is imperative that the following issues are addressed as a matter of urgency:

- Reactive power charging should be reviewed, and the factor of 0.9 that has previously been used (and driven customer investment) should be reinstated. The way in which this charge has been derived bears no relation to costs incurred by the Distribution Company, is completely opaque, volatile over time (thus undermining investment in this area) and utterly unacceptable within the context of a 'cost reflective' charging structure.

- Overall charges must be capped

- Where individual customer costs increase by more than 20%, a phased implementation of over a five year period should be introduced.

We trust that the concerns we have expressed about the methodology will be acknowledged and satisfactorily addressed.