



Energy for
generations

Andrew Self
Targeted Charging Review, Energy Systems Transition
Ofgem
By email: TCR@Ofgem.gov.uk

01 February 2019

Dear Andrew,

Targeted charging review: minded to decision and draft impact assessment

ESB Generation & Trading (ESB GT) welcomes the opportunity to respond to Ofgem's statutory consultation on Targeted charging review: minded to decision and draft impact assessment.

We support in principle a review of the electricity network residual charging arrangements, however we have concerns with the approach taken by Ofgem and suggest that further work and analysis should be undertaken and shared with the industry prior to any decisions being published in Q2 2019.

The annex to this letter provides detailed answers to the questions set out in the consultation document. Our main thoughts on the consultation document and the overall TCR process are highlighted below.

Baseline scenario used in the Impact Assessment is not representative of the status quo

- We are concerned that the assessment of impacts of this TCR appears to be placing reliance on comparison to a baseline scenario which assumes residual reforms have already been implemented. We believe a range of scenarios should have been presented as part of this consultation to reflect true impacts of the proposals relative to the status quo situation of the market. This would be more transparent for the reader, and provide a more efficient set of data to allow better interpretation of findings and TCR impact assessment.
- Based on our understanding of Ofgem's assessment, the extent of impact of each proposal will vary by type of generation technology. In our view, this in itself creates new distortions in the market and leads to investor uncertainty.

Lack of detail around implementation design may lead to unintended consequences

- We also note the lack of detail around further aspects of implementation and exact design features of the options taken forward. This makes it difficult for stakeholders to provide fully informed feedback and assess all material implications of each proposal. For instance, it remains unclear how the TGR cap proposals will be implemented within the current framework and in line with EU 838/2010 rule. This needs to be clarified before full consideration of proposals can take place.
- In addition, we believe that putting critical aspects of implementation design under review outside this consultation increases uncertainty over future impacts and potential knock-on effects that may lead to new market distortions in the future. We see a high risk of unintended consequences with this approach.

Interaction with other market reforms needs to be clarified

- We suggest that any interactions identified between this TCR and the SCR on Access Reforms undertaken by Ofgem should be shared with the industry as soon as possible, to ensure industry discussion and to provide a holistic approach to network charging review. We would welcome a more open, evidence-based and transparent approach to identifying and managing this interaction in order to ensure a holistic approach to assessment and to avoid cross contamination of material impacts.
- More fundamentally, with challenges faced by the industry not limited to TCR, SCR on Access Reform and Capacity Market suspension, the electricity market is currently facing an unprecedented volume of change. Therefore, suggesting radical new arrangements can greatly increase uncertainty for existing and potential market participants. We are disappointed that impacts on investor confidence have not been appreciated nor incorporated in the analysis.

Wider energy policy objectives should be taken into account

- It is vital that any changes made under this review are in accordance with wider Government energy policy objectives, such as encouraging low-carbon technologies and delivering secure and efficient capacity alongside new flexible technologies.
- It is concerning that elements of this SCR have varied effects on different types of generators and overall impacts are not equal in their materiality. The documentation suggests that the proposals should be considered in combination as offset to one another, but there is imbalance between benefit and detriment between generators.

More material concerns with BSUoS charging will still need to be addressed

- We feel that BSUoS proposals do not address more critical attributes of the BSUoS charging regime that lead to defective market arrangements. The industry has repeatedly expressed concerns that volatility of BSUoS is a more pressing issue than the recovery method or the charging base itself. Moreover, given the significant impact of TGR proposals and wider electricity market changes on large generators, it has never been more important to address the distortion in cross-border competitiveness arising from BSUoS levied on domestic generators. We also note that various code modifications to address these discrepancies have been put forward by the industry. We would urge Ofgem to capitalise on the comprehensive and detailed work already done to date in order to develop a more effective solution to fundamental issues with BSUoS.

Finally, we would welcome a more open and transparent development of outstanding elements of the proposals, with more opportunity to engage and comment before final direction is given by Ofgem.

We hope these comments are useful. If you would like to discuss our response in more detail, please do not hesitate to get in touch by reply to this submission.

Yours sincerely,

Kirsty Ingham
Kamila Nugumanova

Regulation, ESB Generation & Trading

ANNEX 1: Responses to consultation questions

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

Attributing transmission residual charges to demand only, while desirable in theory, could raise additional considerations including unintended consequences on wider electricity market arrangements.

Market Risks not factored into the analysis

Whilst Ofgem's analysis acknowledges that transmission-connected generation will require an additional £5-10/kW to be recovered as a consequence of TGR reforms, it places too much emphasis on the modelled market behaviour. There is little further information on impacts on wider system and capacity mix in case this additional revenue is not secured by large generators.

Specifically, the model used for the analysis assumes that generators will be able to recover the loss through CfD or CM clearing and strike prices. Economic theory might suggest that this is the likely outcome. In reality, it is difficult to model behaviour of the market, especially taking into account an increase in Interconnector participation in the CM, and parties may be unable to recover the loss via these routes. Additionally, current uncertainty with CM suspension raises further questions about the ability of generators to use this mechanism in the future. While it is understandable that this temporary suspension could not be modelled into the analysis at the time of publication, the risks with CM future auctions should have been noted for consideration.

Impact on wider policy objectives

More importantly, according to Ofgem's assessment current renewable development projects may not have a route to recover the loss of TGR credit, either due to inability to access CM and CfD mechanisms or due to existing contract arrangements. In light of the impact that this could have on intermittent plants at a time that we are trying to increase the share of renewable generation on the system, we believe that it would not be favourable to pursue this further.

All residual charges should be included in the reforms

We note that little analysis has been put forward in the consultation to suggest that residual elements of BSUoS charges should also fall under Ofgem's key principles. It is only reasonable to assume that all residual charges should be levied on demand side. Singling out residual elements in some charges may lead to discrepancy in Ofgem's approach and minded-to thinking. Therefore, a more holistic review of the treatment of residual charges would be welcome.

Uncertainty over implementation

We are concerned with the lack of detailed design of the TGR proposal and amendments to wider TNUoS methodology that may be required to effect the change. It is unsatisfactory for stakeholders, and especially those who seek to analyse the materiality of impacts of this change, if there is a gap in the proposal and only an indication that there is likely to be a solution or modification, which is being developed outside of this consultation. Specifically, significant questions remain over what National Grid's proposal will be with regards to aligning the TGR cap with interpretation of EU 838/2010 rule and how such a proposal would interact with both current and new arrangements.

We strongly believe that this uncertainty greatly increases the risks of new distortions or unintended consequences.

This lack of practical detail and completeness limits our ability to comment on the appropriateness of the proposed change and any real benefits it might deliver for all users.

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

Our overriding view is that there is no compelling evidence in the assessment to demonstrate any significant benefit to the market.

Approach to impact assessment and benefit calculation:

We do not believe that the introduction of measures in each area of the review would equalise impacts of this TCR on each generator type, since the materiality of impacts differs significantly. We, therefore, believe that the suggested proposals would increase costs for all generators and consequently for consumers, and would create new distortions in the market.

The lack of comprehensive design of the suggested proposals, and in some instances insufficient detail, makes it difficult to comment on some of the elements of TCR, such as the TGR changes. Without further information and understanding of consequences it is not possible to determine whether TGR changes meet the principles and criteria set out by Ofgem. Further work and industry consultation needs to be undertaken before any final directions are given by Ofgem.

Assessment of impacts:

We also do not agree with some of the assumptions and findings used in the assessment. In particular, we feel that the following conclusions may not fully reflect true market conditions:

- Ofgem's analysis assumes that generators will seek to recover £5-£10/kW as a result of TGR changes. The primary vehicle for recovering this additional cost is either CM or CfD mechanism. As mentioned in our response to Q1, the analysis is based on a modelled bidding behaviour of participants in those auctions, whereas in reality generators may not be able to recover this loss, especially bearing in mind recent CM clearing prices and lower CfD pot for Round 3 allocation. In addition, the analysis does not provide for a scenario where the CM is not reinstated, either at all or in its current design.
- Similarly, we do not agree with the statement that increased CM clearing prices will lead to new CCGT investments. The highest modelled price of £25/kW is unlikely to encourage sufficient new capacity of CCGTs. Yet the analysis shows that there is a decrease of 1.5. GW in CCGT installed capacity by 2030. It remains questionable how this reduced capacity of low carbon dispatchable generation is likely to be replaced.
- More importantly, the risk of creating new distortions among transmission-connected generators has not been given due consideration. Since there is still uncertainty around the exact implementation of the TGR 'zero' cap, it is not possible to reflect all risks that may be triggered by the preferred solution. In particular, if allocation of certain elements of TNUoS such as local circuit charges to connection payments is the preferred solution, it may have a significant detrimental effect on onshore and offshore wind assets creating barriers to entry and discriminatory treatment of these technologies.
- The analysis is based on the TGR value from National Grid's 2017 forecast. Latest forecast envisages an even higher value for TGR, which means the impact would be more extensive than as reported in the consultation.
- With regards to BSUoS reform, Ofgem's assessment concludes that CCGTs and transmission-connected generation become *more competitive* as a result of these measures. We disagree with such an assumption for a number of reasons:
 - Firstly, the expected reduction in BSUoS average cost is not significant enough to offset the reduction in TGR.
 - In addition, whilst the average BSUoS price is still relevant, the biggest risk for some generators will be volatility of BSUoS on a half-hourly basis and exposure in any given settlement period.
 - It is noted in the assessment that peaking plants will be less affected by the reforms, whilst other forms of generation like CHP, storage and solar are

more at risk of being materially affected. This is likely to make CCGTs even less competitive in the CM as well as BS and BM markets.

- Lastly, while the hypothesis in the analysis is that competitiveness of embedded generators will be impacted by full BSUoS reform, it is unclear what percentage of embedded generators will be affected by the loss of BSUoS avoidance charge. It is our understanding that not all generators have supplier agreements in place. This means that only a small percentage of generators might be affected under partial BSUoS reform, while remaining generators will only be affected by a single BSUoS charge on dispatch.
- More fundamentally, we do not agree that BSUoS reforms will lead to a reduction in charges that demand users pay. In our view the analysis relies excessively on the nominal value of the charge. Embedded generators currently offset full BSUoS charges for demand consumers leading to lower charges. Moreover, consumers pay for BSUoS twice to a certain extent, one charge through demand tariffs, and the pass-through of generator BSUoS charge included in the wholesale price of power. In addition to this there is a likely risk premium associated with the volatility of BSUoS also passed through to the final price to demand customers.
- Finally, we do not agree with the conclusions that transmission-connected generation becomes more competitive relative to interconnectors. Neither interconnectors participating in the GB market nor generators participating in cross-border trade pay an equivalent of BSUoS. Thus, the BSUoS charge for GB generators, whether reduced or not, will still create cross-border distortion. We believe CMP 308 would have been a better solution to address this issue.

With regards to the principles set out by Ofgem for this assessment, it is our view that, in light of the impacts of the proposed changes on the overall GB energy market, Ofgem should have also used principles that cover wider policy objectives.

- 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 no comments on demand residual charging options presented in the document.



- 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.**

We have no comments on demand residual charging options presented in the document.

- 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)?**

We have no comments on demand residual charging options presented in the document.

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

We have no comments on demand residual charging options presented in the document.

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

We have no comments on demand residual charging options presented in the document.

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

We have no comments on demand residual charging options presented in the document.

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?

We have no comments on demand residual charging options presented in the document.

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.

No specific views on demand residual proposals.

On non-locational embedded benefits proposals please refer to our response to Q2.

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

We agree that moving to gross charging represents a fair way of recovering BSUoS charges.

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.

We support Ofgem's decision not to address other remaining embedded benefits at this stage. In light of wider industry changes, these seem to be immaterial and less pressing. We also note that Ofgem's SCR on Access reform and Forward Looking charges will review several areas of charging and will seek to remove any distortions identified. As noted above, we would welcome transparency and an evidence-based approach to be used by Ofgem in conducting this further analysis.

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

We have noted some of the unintended consequences originating from implementation of changes to embedded benefits in our response to Q 1 and Q 2.

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 believe that phased implementation from 2021 to 2023 would better facilitate effective introduction of the reforms and will strike the right balance between delivering benefits for consumers and avoiding disruption for energy market players.

In addition, it is critical that any further information or implementation updates are shared with the industry as soon as practicable to avoid further investor uncertainty, and to enable existing parties to factor the changes into their systems and pricing.

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

Whilst we agree with the high-level objectives of the review and proposals in principle, we do not believe that this minded to decision sets out a comprehensive and detailed outline of the proposals. Without further clarity and understanding of the full implications, it is not possible to determine whether the reforms proposed by this decision will deliver real value.

More importantly, we believe it is imprudent to effect such material market interventions without fully understanding their interactions with the multitude of other changes in the sector, including the SCR on Access reform, BSUoS Task Force work, CM suspension, uncertainty with Brexit and EU energy market alongside other wider market developments. The current level of change is unprecedented and there is a high risk of unintended consequences.

More specifically, it would be preferable to await the outcomes of the BSUoS Task Force and National Grid modification work before giving final direction to the industry. Any changes should be developed with a clear understanding of future market developments and potential interactions with electricity market arrangements. It is our view that more time is required before such impacts and interactions can adequately be gauged. Proceeding without a full understanding of potential new risks and unintended consequences has major risks including poor outcomes for consumers and industry participants as well as creation of new distortions and failures in the market.

16. For our preferred option do you think there are practical consideration or difficulties that we have not taken account of? Please provide evidence

We are mindful that work on some elements of the proposal is being undertaken through industry modification processes. Industry processes and timelines for progressing modifications should be taken into account when finalising any directions on implementation dates.

Furthermore, as noted in our response to Q 15 and elsewhere above, the SCR on Access Reform may give rise to a number of potential interactions with the proposals of this TCR that we believe should be considered in more detail.