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Andrew Self,
Ofgem
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4th February 2019

Dear Andrew,

“Targeted Charging Review: minded to decision and draft impact assessment”

InterGen remains one of the few genuinely independent generators active in the GB market, with a track record of developing, constructing and operating large scale thermal power generation projects. We have been active in the market since the 1990s.

As one of GB's largest independent generators, we operate a portfolio of three flexible gas-fired power stations totalling 2,490MW; representing almost 2.5% of GB generating capacity. In addition to this £2.1bn investment InterGen was awarded a fifteen-year agreement to construct a 300MW OCGT at our Spalding site in December 2016 at the T-4 Capacity Market auction, which is currently under construction.

Ofgem’s principle objective is to protect the interests of existing and future energy consumers. With this in mind InterGen would urge Ofgem to take a whole systems view when assessing the impact of such wide ranging reforms. Equal credence as to the impact of this targeted charging review must be given to existing assets as well as projects under construction or in the planning process. Decisions made this year will impact the financial attractiveness of projects that are significantly advanced in planning or even under construction may cause delay (or even jeopardise the completion of) projects, that will underpin the UK’s commitment to security of supply.

InterGen would also stress that the predictability and stability of charging levels are almost as important as the level at which the charges are set. GB generators must use a long term view to make decisions on continuing to make substantial investment in existing assets. These can be assets that are essential to maintain levels of security of supply and are bidding in to the capacity market 4 years ahead. Proposing to make overarching changes to elements of charging that underpin these investment decisions within a shorter timeframe is likely to have a detrimental impact on the ability of some of these assets to continue to operate in the market. In that regard, InterGen believes that delaying the introduction of the changes proposed in this SCR in line with capacity market auctions and RIIO cycles is the only option to ensure the modelled ‘cost to consumers’ is achievable. We expand on this in our more detailed response to the consultation questions below.

Please do not hesitate to get in touch with me should you have any questions regarding any of the points raised in this response (lmackay@intergen.com; 0131 624 7500). In addition, should you wish a meeting to discuss our comments I would welcome such an approach.

Yours sincerely

LMackay

Lisa Mackay
Commercial and Trading Director, UK

Targeted Charging Review: minded to decision and draft impact assessment

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

It is important to understand the impact any charging changes will have on traditional transmission-connected generation. The current and forecasted negative transmission generation residual charges will have been reflected in generators Capacity Market (CM) bidding strategies and therefore will have lowered the clearing prices of previous auctions. We note that the Frontier Economics Impact Assessment states that "we judge the risk of early closure of generation….to be very low, since affected generation is… able to bid into the capacity market". The Frontier Economics analysis then goes on to predict increased CM clearing prices as a result of the proposed changes and Ofgem should be mindful of this when considering the implementation timeline as CM agreements already entered in to will remain fixed. If the changes are implemented in advance of the auction timings it is likely this will have unintended consequences around asset hedging decisions and implied running across the next 3 years, meaning increased balancing costs for National Grid.

The Impact assessment goes on to describe how "on the basis of the modelling, the proposed reforms would have a relatively limited effect(s) on wholesale energy prices" and describe the impact on the cost of capital to be "immaterial". InterGen would stress that the impact of these proposed reforms will indeed adjust the wholesale cost of energy, TNUoS being such a large fixed cost, particularly with more mature assets already requiring CM revenues to continue to operate due to the increasing de-linking of wholesale market costs and 'actual' costs of generation. The cost to consumers of such wide ranging reforms must be viewed in light of potential early closure of existing thermal assets (already suffering in light of the CM suspension) that provide reliable, flexible, mid-merit generation. To suggest that TNUoS charges changing from highly negative (a payment) to positive (a charge) will have little or no discernible impact on existing generation would be a significant oversight.

As with any significant code review of this size, consideration needs to be given not just to the impact on generators and customers already operating in the GB market, but to those projects in development (whether that be at planning or construction stage) and how they may be impacted by such wide ranging reforms. This is particularly pertinent for independent generators such as InterGen who finance their projects using project finance (debt) and therefore need to take a very long view on the costs and revenues associated a standalone project, as do the banks and institutions who lend in the UK. Whilst reform is often necessary to ensure a 'fit for purpose' regulatory landscape, care must be taken to work towards periods of stability in the GB marketplace so that much needed investment in new generation can come to fruition. To this end, InterGen has clear views on the timing of the implementation of the proposed changes which we discuss in more details in our response to Question 13.

InterGen would also support a more wide ranging discussion regarding the current charging methodology for energy storage projects, as highlighted by National Grid and other responders to the initial 'Targeted Charging Review' consultation in May 2017. As storage becomes increasingly important for the system and consumers, the charging methodology should adapt so that inappropriate charging does not present a barrier to entry for storage developers. The methodology should be revised to avoid any undue double charging, and to ensure fair treatment of storage compared to other parties. InterGen would welcome a review of how a new type of licence for storage could be implemented to improve the pricing signals for this class of technology.

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.**

   Please refer to InterGen's answer to Question1.

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?**

   InterGen has no comment on this at this time.

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 believe that use of a Fixed Charge for users in a certain Line Loss Factor Class (LLFC) could result in significantly higher charges for smaller consumers, who are also more likely to be unaware of the proposed changes due to their size (smaller organisations or domestic customers). We would hope that Ofgem have a mechanism for ensuring that modelled impacts on such organisations are accounted for, even if responders to the consultations may not be well represented. Likewise, Fixed Charges will result in energy intensive users paying proportionately less than other users who have reduced demand but are in the same LLFC which seems to be at odds with other transmission charging principles where users pay dependent on size and their impact on the system. With this in mind, InterGen is minded to support the introduction of an Agreed Capacity Charge over a fixed charge, as we feel this more fairly represents the size of the user, as less energy intensive users will be disproportionately penalised.

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)?**

   Yes. In principle, similar parties should pay the similar charges and embedded generation should not be excluded from that charge. We therefore agree it is appropriate for the recovery of these residual charges to treat equitably behind-the-meter and metered generation.

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

Investment in large and small scale generation projects is bound to be impacted by any reforms of this scale. Not only do the economics of a project change significantly, the impact on the willingness of such projects to attract finance cannot be underestimated (however is very hard to quantify). We note that the Draft Impact assessment states that "with any change to charging there may be cost of capital implications but we considered these quantitatively and expect them to be immaterial in this context". We would strongly disagree with this statement; any changes of this scale to a large element of a generator's fixed costs which are out with the control of the developer will absolutely result in a higher cost of capital for new projects (and therefore ultimately consumers).

In the long term, consumers will benefit from a clear pathway for the direction of charging arrangements. InterGen will be following closely the Electricity Network Access and Forward-Looking Charges Review project, in particular proposals to reform other aspects of TNUoS and BSUoS within that scope of work. We hope that once these significant revisions have concluded that a more stable regulatory charging landscape can provide the stability investors need to proceed with projects that support the UK's security of supply and low carbon objectives. It is therefore essential that changes to the CUSC as a result of this TCR and the Forward-Looking Charges Review are implemented at the same time, giving industry time to prepare and giving more clarity and certainly to investors in new generation projects of any size. Ofgem must also be mindful of the CM lead time and ensure that any TNUoS charging changes are in alignment with the current CM auction round and delivery years to allow generators sufficient time to reflect the impact in bidding strategies.

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

   We agree that against the other options evaluated, the two leading options should be reasonably practical to implement.

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

   As referenced in our response to question 4, InterGen believes that Agreed Capacity Charges appear a more equitable way of charging being directly related to users' use of the system, whilst still removing the most existing harmful distortions. Under the Fixed Charge Option, it should be the case that additional bands be added within each LLFC to split out smaller and larger users within a band. This will avoid users at the upper level of a band receiving a windfall and users at the lower end being penalised due to classification (as opposed to paying use-reflective charges under the Agreed Capacity Charge option).

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?**

   Please see our response to question 4.

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.

Please see our response to Question 13 with regards wider system modelling and the impact on capacity market revenues.

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

    In principle InterGen can agree with the direction of reform that levels the playing field for generators connected at different connection points across the network. However, the timing of the implementation plays a crucial part in investor confidence, for example assurance that reform does not undermine contracts for those already entered into 15 year Capacity Market Agreements, ensuring overall competitiveness against European interconnected generation is not diminished and that signals from other reform (i.e. Network Access and Forward-Looking work) is co-ordinated to send consistent investment and also operational signals to the market.

    InterGen welcomes the direction from Ofgem to the Electricity System Operator to address its new interpretation on compliance to European Regulation EC838/2010 – this is a clear example of ensuring that other reform is considered through TCR implementation.

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

    InterGen has no comment on this at this time.

13. **Do you agree with our proposed approach to transitional arrangements for reforms to: a) transmission and distribution residual charges b) non-locational Embedded Benefits?**

    In its Retail Market Review, Ofgem suggested that TNUoS changes are passed through at the next contracting rounds *as a minimum*, i.e. 18 months delay (this would be in line with internal hedging strategies that can range from 18-36 months into the future). InterGen continues to support this view that adequate time needs to be given to large scale reforms to allow the cascade of changes to be accurately reflected in wholesale prices and the myriad of existing contracts that will be impacted, in order to avoid ‘winners’ and ‘losers’ emerging due to the timing of the TCR changes.

    InterGen note that in the Frontier modelling (“Wider System Impacts of TGR and BSUoS Reforms”) it is anticipated that the impact of these options presented in the minded-to decision will result in an increase in the Capacity Market bids in the range £5-£10/kW/yr. This modelling starts in 2023 presumably to reflect the fact that the next T-4 capacity market auction is for delivery year 2022/23 (dependent on when the decision on this SCR is announced). Introducing these reforms prior to the 2022/23 delivery year may undermines investment decisions based on the Capacity Market clearing price during previous years, which would have been based on a significantly different charging landscape for transmission connected generation. InterGen urges Ofgem to consider implementing all of the proposals set out in the SCR (setting fixed or agreed capacity charges; and the changes to other embedded benefits) in charging year 2022/23 to align with investment decisions already taken. At the very least a phased approach is the best option when the reforms will have an impact on generation fleet to the value of millions per annum.

Additionally, the TCR proposals note that the ESO is developing a modification which would enact the post CMP261 definition of the €2.50/MWh EU cap, and would allow Ofgem to ensure that the stated policy position of no residual charges to generation is met. From a practicality perspective, the industry is unlikely to get a sight of these exact proposals by the deadline for TCR responses submission. Therefore it is impossible to have a view on all related issues that may arise and the proposed implementation dates might be too ambitious and do not give the industry sufficient time to put all necessary arrangements in place.

InterGen agrees that the implementation of these reforms should be aligned with work underway on Network Access and Forward-Looking Charges and BSUoS reform as stated previously.

14. **Please provide evidence to indicate why different arrangements would be more appropriate.**

    See answer to Question 13.

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

    InterGen is concerned that with the CM being suspended (and the resulting impact to investor confidence in the CM, even if it is fully reinstated and missed payments are made in the coming months) and this TCR looming, existing large-scale generation will be impacted in addition to the viability and cost of new developments already underway. We urge Ofgem to consider the impacts on cost of capital more fully before opining on these reforms based on existing modelling of perceived consumer benefits. It is essential that whatever the outcome of this SCR, that the implementation schedule is given sufficient lead time to allow generators (and developers with projects underway) to adjust CM pricing methodology and revise other long term contract where TNUoS is significant fixed cost.

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

    InterGen has no comment on this at this time.