

27th August 2021

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Non-confidential

Dear Patrick,

Network Access and Forward-Looking Charges Minded to Decision

Drax Group plc (Drax) owns and operates a portfolio of flexible, low carbon and renewable electricity generation assets – providing enough power for the equivalent of more than 8.3 million homes across the UK. The assets include Drax Power Station, based at Selby, North Yorkshire, which is the country's single largest source of renewable electricity. Drax also owns two retail businesses, Haven Power and Opus Energy, which together supply renewable electricity and gas to over 390,000 business premises.

In responding to Ofgem's minded-to decision, we've not answered the discrete questions posed as we don't have firm views on many of them. Instead we've focused on providing views more broadly across the proposals which we hope will be more helpful and instructive for Ofgem. In summary:

- We do not believe certain aspects of Ofgem's minded-to decision are compatible with the Guiding Principles of the Significant Code Review (SCR).
- We're concerned by the lack of granular detail in the minded-to decision. Consequently, we've been unable to fully evaluate the proposals and their implications. We'd therefore welcome additional clarification and detail ahead of the final decision, so that we can better inform Ofgem's decision-making and avoid sub-optimal conclusions being reached.
- The final decision will need to be significantly more detailed to give clarity and ensure well-defined industry code modifications can be raised and effectively delivered, in particular, the methodology for calculating TNUoS charges for Small Distributed Generation (SDG).
- We believe the CEPA analysis is insufficient and relies on many unpublished assumptions. It focuses on quantifying consumer benefits but doesn't analyse the impact on market participants. It therefore doesn't consider the wider impact of the proposals, for example, the proposed TNUoS tariffs for SDG and the indirect impact this has on other TNUoS liable generation and demand parties.
- In principle, we support the objective to ensure a level playing field between SDG and large transmission connected generation. However, we don't believe the indicative tariffs in table 5.2 and 5.3 of the CEPA

report would achieve this because, for instance, they suggest that SDG would primarily receive a credit, even in regions where transmission connected generators would face costs.

- The indicative tariffs may be incompatible with net zero policy objectives, as the signals sent through the tariffs could hinder the deployment of net zero technologies.
- We support a phased implementation of TNUoS charging for SDG over three years starting from 2024 (or later), once there is full clarity on the future structure of TNUoS charges.
- We are generally supportive of the distribution connection charging and distribution network access rights proposals. However, the wider impact on network charges needs to be considered and the benefits of non-firm or time-profiled access need to be better defined.

More detailed commentary is provided in the appendix.

We'd welcome the opportunity to discuss our views with you further.

Yours sincerely,

Matt Young

Group Head of Regulation

Appendix – Detailed Response

1. Charging TNUoS to Small Distributed Generation

Distributional effects and distortion

We support the policy objective to ensure a level playing field between SDG and large transmission connected generation. However, we don't believe the draft tariffs in the CEPA report would achieve a level playing field. A level-playing field would best be achieved by introducing a cost on SDG in certain locations and a credit in others, such that it aligns with the charging signals sent to transmission connected generation through TNUoS.

The indicative tariffs suggest that most distribution connected generators would receive a credit, apart from some generators (low carbon and intermittent) in zones 1 – 4. This is not intuitive as it's sending different signals regarding location and technology type to those sent through existing TNUoS for larger generators, and we question how reflective this is of the costs that small distributed generators drive on the transmission network. As a result, the indicative tariffs may inadvertently lead to a greater distortion between different sized generator.

The methodology and assumptions behind the calculation of the indicative tariffs isn't transparent. Further detail is needed to fully understand the impact of the proposed reforms on generators and customers. For example, it's not clear why demand zones have been used rather than transmission generation zones; we believe the charges for SDG should reflect the impact they have on the transmission network not distribution network demand zones. Moreover, without understanding the detailed methodology, it will be difficult for industry to implement the proposed reforms through code modifications because there will be many different ways to derive SDG tariffs which will have varying outcomes.

Tariff uncertainty

The proposals introduce significant uncertainty. It's not clear what the indirect impact would be on existing generation and demand TNUoS tariffs. The CEPA report briefly mentions the impact on transmission connected generation tariffs stating *"This results in small changes to the charge faced by transmission-connected generators which apply equally to all generators regardless of location. This results in a decrease in the overall Generator TNUoS of about £0.3/kW in 2024 and an increase of around £1/kW in 2040."* It's not clear how this was calculated or if it's a linear or non-linear transition between 2024 and 2040.

Furthermore, the report includes indicative TNUoS tariffs for SDG in 2024 (table 5.2) and 2040 (table 5.3), but the magnitude of tariffs is significantly different between both tables. It's unclear why this is and if it's expected to be a linear or non-linear transformation.

We are not clear how the small distributed generation volumes and money collected through the proposed tariffs would be considered in the €0-2.50/MWh range on generation tariffs. Different interpretations will lead to significantly different distributional impacts. Equally, the corresponding impact on demand TNUoS tariffs is unknown. Generators and suppliers typically enter into fixed-term, fixed-price contracts and without understanding how different tariff elements will be impacted by the proposed arrangements, it will be difficult (if not impossible) to efficiently price TNUoS into those contracts. Industry needs more accurate and robust draft tariffs on the new proposed charges, and an indicative impact on existing TNUoS charges.

Compatibility with net zero

The proposed reforms may not be wholly compatible with the move to net zero. Draft tariffs in tables 5.2 and 5.3 of the CEPA report provide indicative TNUoS charges for SDG varying by technology type (Conventional, Low Carbon and Intermittent). Irrespective of location, tariffs for conventional carbon generation are negative and always less than those charges faced by intermittent generation. This is exacerbated in Scottish zones where intermittent SDG face a significant penal cost whereas conventional generation still receive a credit. This may have an impact on the deployment of renewables in Scotland and without visibility of the methodology used, it is difficult to justify. We also note that this doesn't align with the current TNUoS charging methodology for large transmission connected generators in Scotland, whereby charges are positive for both technology types and are lower for intermittent generators since they don't pay the "Peak" tariff. This further illustrates the inconsistency between the existing TNUoS model and the opaque methodology chosen to derive the SDG tariffs.

When assessing the impact of the proposals on reaching net zero, the analysis assumes that the reduction in investment in Scottish wind will be equal to the increase in new solar generation in the south of England. We are unconvinced that this is a plausible outcome. There are many large wind projects currently under construction and historically far more wind capacity has been awarded CfD contracts compared to solar. Whilst the new tariffs would signal investment in southern solar rather than Scottish wind, we don't believe this will be sufficient to completely reverse the current trend. We suggest this assumption should be reviewed.

Threshold for charging SDGs

The minded-to decision explores a threshold beyond which SDGs would not be charged TNUoS. We agree that it's not possible or efficient to charge all SDG TNUoS. Doing so would be extremely burdensome for the ESO and complex for suppliers to pass through in consumer contracts. We therefore agree with the need for a cut-off point where SDGs are no longer charged. However, we don't believe there has been sufficient justification for setting the cut-off point at 1MW. We would appreciate more robust justification and analysis on the split of distribution connected capacity above and below 1MW to ensure this is the correct level to set the cut-off point and isn't just an arbitrary figure. It would be sensible to consider how other charging regimes and market arrangements determine any cut-offs. For example, the FiT scheme is only available for generators below 5MW, with those above required to use the Renewables Obligation Scheme. There could be merit in aligning the TNUoS charging cut-off for SDG with this figure.

Implementation

Finally, there is considerable uncertainty with regards to the future of TNUoS charging. Several high impact modifications are progressing, and this minded-to decision only captures part of the proposed SCR scope. It's critical that any new arrangements are assessed holistically, not in isolation from the arrangements intended to be proposed in the second minded-to decision, expected later this year. To mitigate the risk of a large unforecastable increase in costs for some generators, we would support a phased implementation over three years starting in 2024 (or later) once there is more certainty on the wider charging arrangements.

With regards to grandfathering, there has been no analysis illustrating what the impact of such an implementation approach would be, it's unclear how many parties would be eligible and for how long, this would have a consequential impact on tariffs for others and wider generation and demand TNUoS charges.

The impacts of grandfathering arrangements need to be fully considered before a valid decision can be made.

Summary points:

- The draft tariffs in the CEPA analysis would not lead to a level playing field between SDG and transmission connected generation. They also do not appear compatible with net zero ambitions.
- The methodology behind the draft tariffs and assumptions in the analysis are not transparent; this information is critical to evaluate the proposals.
- The lack of detail in the minded-to decision and CEPA analysis leads to significant uncertainty for market participants and the charges they will face. Making a robust assessment of the minded-to decision will not be possible without additional clarity.
- We agree with the need for a threshold where SDG are no longer charged. However, we don't believe there has been sufficient justification for setting the threshold at 1MW.
- We would support a phased implementation over three years starting in 2024 (or later) once there is more certainty on the wider charging arrangements.
- Further detail and analysis is needed to fully assess the impacts and appropriateness of grandfathering arrangements.

2. Distribution Connection Charging

We're supportive of the proposals to reduce the upfront contribution to reinforcement costs for generation and completely remove them for demand. In our experience, upfront connection costs can be prohibitive and so we agree the proposals will help remove a barrier to demand (e.g. EV car park) and generation projects looking to connect to the distribution network.

We support the complete removal for demand and partial removal for generation. Demand connections are unlikely to respond to any locational signal sent through connection charges, whereas generators are more likely to be able to respond. Retaining the partial signal for generation should ensure that new connections don't lead to an inefficient rise in whole system costs.

That said, we are unclear what the materiality of the partial removal of reinforcement costs for generation is. We would welcome illustrative examples under both the counterfactual and proposed position to better understand the proposed methodology for calculating reinforcement costs.

The reinforcement revenue that would have been paid directly by the connecting party will now be socialised through DUoS. Market participants have no indication of what the magnitude of this increase might be and we would have welcomed analysis on this. Overall, we support the proposed implementation in 2023 but emphasise that tariffs should be subject to the standard 15-month lead-time for DUoS charges to ensure they can be priced into contracts and efficiently recovered from customers.

Summary points:

- We're supportive of the minded-to decision to reduce the upfront contribution to reinforcement costs for generation and completely remove them for demand.
- It is unclear what the materiality of the partial removal of reinforcement costs for generation is - some illustrative examples would be useful.
- The proposals will result in additional revenue being recovered through DUoS but there has been no analysis published on the materiality of this.
- Implementation in 2023 is reasonable but tariffs must be subject to the standard 15-month lead-time.

3. Distribution Network Access Rights

We're supportive of the increased choice and definition of access rights but we're unsure what appetite there will be to select either non-firm or time-profiled access. We do not believe the benefits of opting for these alternative access rights have been well defined. For these alternative access rights to be adopted by parties, it will be essential that the benefits are transparent and quantifiable.

It's not clear what the incentives for choosing non-firm or time-profiled access would be, for example, benefits could be realised through reduced connection charges, reduced DUoS charges or quicker connection times. The interactions between these different elements and access rights aren't defined in the minded-to decision. For instance, given the proposed reduction in reinforcement costs, it's not obvious how parties would benefit via connection charges, and while quicker connection times would certainly be beneficial, there has been no indication as to the materiality of this benefit. We envisage there will be more clarity on how parties will benefit through DUoS charges once the second minded-to decision is released.

In reaching its final decision, Ofgem should be mindful that suppliers need to forecast and price DUoS charges into consumer contracts. Therefore, any solution should not significantly increase the number of DUoS tariffs or introduce additional complexity to the DUoS charging methodology, as there is already significant complexity being introduced following the TCR.

Depending on the level of uptake and how these access rights are rewarded through DUoS charges, it could have an indirect impact on all DUoS payers through tariffs. As such, while we support the proposed implementation of 2023, we emphasise that tariffs should be subject to the standard 15-month lead-time to ensure they can be efficiently priced into consumer contracts.

Summary points:

- We support the increased choice and definition of access rights but are unsure what the level of take-up will be without well-defined benefits.
- We do not believe the benefits of opting for either of the access rights have been well defined; to foster take-up, it's essential the benefits are transparent and quantifiable.
- We support the proposed implementation of 2023 subject to tariffs having the standard 15-month lead-time.

4. Assessment against the Objectives of the SCR

Taking into consideration the points raised above, we are concerned there has been insufficient justification of the proposed reforms against the SCR Objectives and Guiding Principles, which state:

- *Arrangements support decarbonisation and contribute to meeting net zero targets, signals reflect costs of using the network at different time and places, signals ensure no undue cross-subsidisation between users, users are able to understand arrangements, users have sufficient information to predict their future access and charges and finally distributional impacts for network users.*

Specifically, the indicative assessment in the CEPA report shows that the proposed reforms are likely to lead to:

- An increasingly uneven playing field between large transmission connected generation and SDG. This is likely to have impacts on the competitiveness of market actors who participate in CM, balancing services, and other market mechanisms.
- Cross-subsidisation between users, as demonstrated by the scale of difference in SDG tariffs.
- Undue barriers for low-carbon technologies, in particular, those with specific locational and natural resource requirements that can only locate in expensive tariff zones, i.e. Scotland.
- Additional complexity and uncertainty for all parties given there is a lack of clarity around methodologies, tariff models, assumptions and other aspects of the proposed changes.
- Insufficient assessment of distributional impacts for network users. There is likely to be a double benefit for some users (through a combination of lower connection charges and favourable Use of System charges), whereas other users are likely to be exposed to significant increases in charges.

Summary points:

- The minded-to proposals, particularly in relation to charging TNUoS to SDG, are inconsistent with the SCR Objectives and Guiding Principles.
- The indicative TNUoS tariffs for SDG would have a detrimental impact on competition and investment in renewable generation.
- market participants cannot establish the impact on their network charges due to a lack of detail and transparency.
- There has been little analysis of the wider distributional impact of the proposed reforms.