

Zenobe Response to Ofgem Consultation on CMP308

*1. Do you agree with our assessment that CMP308 better facilitates the Applicable CUSC Objectives?*

We agree that CMP308 better facilitates ACOs a, b, and e.

- a) We agree that CMP308 will facilitate effective competition in generation by removing distortions between interconnectors, small distributed generation, and large generation, levelling the playing field. We agree this will incentivise investment according to the merit order – though as we discuss below, we believe further regulatory measures should be introduced to ensure that this investment is concentrated in low-carbon forms of generation (i.e., renewables, not gas).
- b) We agree that removing BSUoS for generators will eliminate a non-cost-reflective charge, resulting in more cost-effective and efficient self-dispatch. We also agree that in moving from generation to demand, BSUoS charges would shift from more price-responsive to less price-responsive users.
- c) We agree CMP308 is neutral with regard to ACO c, ‘taking account of developments in transmission licensees’ businesses’.
- d) We agree CMP308 is neutral with regard to ACO d, ‘compliance with the Electricity Regulation’.
- e) We agree that CMP308 would facilitate efficiency in the implementation and administration of the charging methodology.

*2. Do you agree that charging BSUoS charges only to Final Demand reduces distortions between Large Generators and other forms of generation? Please explain why.*

We agree that charging BSUoS to final demand only would reduce distortions between large generators and other forms of generation. Removing distortions between generators of different size and connection voltage is likely to increase investment in efficient generation solutions.

However, as we discuss below, we think that Ofgem should consider implementing further measures to ensure that CMP308 does not result in increased investment in GB gas generation, which would conflict with the UK’s legally binding net zero targets while sustaining exposure to gas price shocks.

*3. Do you have any views on the impact of this proposal on Behind The Meter Generation and its competitiveness?*

We agree that CMP308 will improve the demand-side benefit of BTM generation, enabling demand users to reduce or avoid BSUoS charges by using power from exempt onsite generation. This would give BTM an advantage over small

distributed generation and interconnectors, creating an incentive for demand users to install BTM assets, and thereby producing a distortion.

However, we agree that this distortion is preferable to the distortion currently in place, as a result of which large generation pays unfair BSUoS costs. Large renewable generation is strategically necessary to decarbonisation and energy price stabilisation than BTM, and energy regulation must incentivise its deployment.

*4. Do you have any views on our reasoning on this proposal's effect on price signals or generation dispatch?*

We agree that CMP308 is likely to result in more cost-efficient generation dispatch.

We also agree that it is likely to make price signals more cost-reflective. By reducing BSUoS costs for large generation, CMP308 will prevent certain types of generation from being more affordable than others due solely to distortive BSUoS charges. This has the potential to bring cheaper types of generation onto market first; to reduce the cost of generation investment; and to reduce wholesale prices, lowering costs for consumers.

We agree that removing BSUoS for generation will likely lead to lower consumer costs, as generators will no longer pass their wholesale costs on to consumers.

*5. Do you have any views on our reasoning on this proposal's effect on competition between different generator types?*

We have set out our views on this matter above.

*6. Do you have views on our assessment of the decarbonisation impacts of this proposal, both in respect of emissions from the GB energy system and of overall emissions?*

We agree that removing BSUoS charges for generation would be a step towards driving increased investment in large generation in the GB energy system. However, contrary to the LCP modelling cited by Ofgem, we think that if current market conditions persist, the case for investment in new CCGT plant will be limited. If CMP308 does result in the construction of new CCGTs, this would intensify the UK's vulnerability to international gas price shocks over the coming decade, and risk locking in carbon-intensive generation.

As noted in the consultation, the LCP modelling does not take account of current conditions in the energy market. That the modelling foresees a rise in CCGT construction as a result of the implementation of CMP308 does, however, show how UK energy regulation continues to enable deployment of new carbon-intensive forms of generation, despite net zero imperatives.

We think UK energy regulation should drive new investment in wind and solar, as well as flexibility technologies. This will provide consumers with secure, affordable, low-carbon energy. While removing BSUoS from generation will benefit renewables and storage, we believe that Ofgem should combine this approach with further regulatory measures to drive immediate investment in secure low-carbon technologies, and to constrain new carbon-intensive generation. This could

take the form of emissions limits in specific energy markets (as recently proposed in the consultation on aligning the Capacity Market with net zero).

We note that LCP's modelling estimates that CMP308 will drive an increase in CCGT emissions only up to 2027, after which emissions are predicted to fall as new renewable generation comes online. We also note the argument that while CMP308 is likely to drive a short-term increase in GB emissions, it is likely to reduce overall emissions associated with interconnected markets. We are uncertain about the accuracy of this latter finding. LCP's EnVision model uses a simplifying assumption that 'interconnectors have the same carbon intensity as the nearest domestic generator within the GB merit order'. This method lacks granularity, especially as UK interconnectors link to comparatively low-carbon markets with high proportions of nuclear (France) and hydroelectric (Norway) power. The interconnectors to the Netherlands and Belgium will also likely have lower carbon intensity than the UK energy mix.

If new CCGT plant did deploy, it would be likely to replace old CCGT assets, rather than to displace interconnectors. CCGTs will likely have higher marginal costs than interconnectors even without BSUoS, due to carbon price support.

We find CMP308 is more likely to drive deployment of new transmission-connected battery storage than new CCGT.

- 7. Do you have views on whether and the extent to which the changes proposed in this modification have already been incorporated into supplier decisions?*

We do not have views on this point.

- 8. Do you have views on the impact of this proposal on existing supply contracts, including the possibility of costs or delayed benefits to consumers stemming from windfall gains to industry parties, or double payments?*

We agree that if CMP308 is approved, it will no longer be appropriate for CfD generators to receive BSUoS protection payments. We also agree that sufficient notice periods will be required to ensure significant double payments do not occur.

- 9. Do you have views on this proposal's impacts on generator and supplier risks, including on exposure to volatile charges?*

We agree with the participant who observed that increased BSUoS charges for demand users could incentivise reduction of demand in generation-constrained areas. This would be counterproductive. However, we also note that demand users are generally less well-placed to respond to price signals. We also agree that this potential undesirable effect would be mitigated if CMP361 is approved, in which scenario BSUoS charges would be flat and volumetric, rather than periodically variable.

- 10. Do you have views on the interactions between this proposal and other changes in the sector, including other BSUoS charging reform proposals?*

Above, we set out our views on how this proposal interacts with decarbonisation and CMP361.

*11. Do you have views on the modelled assessment of consumer and energy system benefits? Please provide quantitative analysis and any further information.*

We agree that CMP308 is likely to result in consumer benefits as it will incentivise construction of more efficient and cost-effective generation, in turn reducing wholesale prices.

We agree that in theory, CMP308 is likely to drive deployment of new large generation. As we have discussed, under prevailing market conditions, we do not think it is likely to drive deployment of new CCGT capacity displacing interconnector imports. We find it more likely to drive deployment of new transmission-connected battery storage.

*12. Is our assessment of non-monetised costs and benefits reasonable? Are there any other factors we should consider?*

We agree that removing BSUoS costs for large generators would incentivise the more efficient delivery of new flexibility capacity in the long term. We also agree that it will free up resources for organisations designated as large generators. We disagree that the reforms would be likely to have a significant impact on interconnector flows, supplanting them with energy from GB large gas generation. We also add that given the two crises of climate change and energy price spikes, the regulator should seek to prevent the UK from deepening its dependence on gas generation.

We agree that no longer levying variable BSUoS charges on generators and having these charges feed into wholesale price bids will reduce complex system interactivity. This would help targeted policy measures to work more effectively, and it would facilitate the identification of systemic risks.

We agree that CMP308 would improve transparency for consumers.

We agree that as a result of CMP308, generators would no longer need to build premiums into their wholesale offerings.

*13. Do you consider the consumer and system benefits identified in our consultants' modelling to represent a reasonable view of the potential effects of this modification?*

We disagree that the modification is likely to result in an increase in CCGT generation and a reduction in interconnector flows. We set out our reasoning for this view above.

Removing BSUoS charges for large generation may drive displacement of distribution-connected battery storage by transmission-connected battery storage. This would have positive system effects.

We find the assessment of the consumer benefits reasonable.

*14. Do you consider that Ofgem has duly considered all relevant consumer and system benefits? Are there any areas which could benefit from further analysis?*

The price security and decarbonisation risks associated with a potential rise in large gas generation could benefit from further analysis. As we have argued though, we find this scenario unlikely.

The modelling does not reflect how CMP308 will benefit transmission-connected battery storage, as well as CCGTs. As well as participating in wholesale markets, battery storage assets provide a unique range of essential flexibility services, enabling them to stack revenues (frequency response, fault current, inertia, and voltage control). Incoming battery technologies have low rates of capital expenditure and short build times. Battery storage enables the deployment of renewable generation, and so it is critical to the UK's net zero goals. These qualities make battery storage an increasingly attractive prospect for investors. Removing BSUoS costs for generation will improve the investment case for transmission-connected batteries.

*15. Our modelling assumes that CfD adjustment payments designed to compensate contract holders for the BSUoS charges they face will no longer be paid in the event generation is not liable for BSUoS charges. Do you agree with this assumption, and do you have views on our assessment of the risks associated with existing CfD contracts?*

As we set out above, we agree that if CMP308 is approved, it will no longer be appropriate for CfD generators to receive BSUoS protection payments. We therefore agree with this assumption.

*16. Do you have views on the impacts of this proposal on end consumers, including large users and vulnerable users?*

We agree that given the low estimated financial impacts on domestic users, CMP308 is unlikely to have adverse effects on vulnerable users.

We agree that there is a risk in reallocating BSUoS costs to demand users at a time of significant financial pressure for many energy-intensive users. However, we accept Ofgem's finding that allocating BSUoS costs to demand users will not unduly add to end user costs, as a result of reductions in other energy system costs, especially if additional reforms reduce the volatility of BSUoS charges.

*17. Do you agree with our assessment that reduced costs to generators are likely to feed through into lower wholesale prices?*

We agree with this assessment.

*18. Do you agree with our assessment that this policy will not have any significant material impacts on vulnerable users?*

We agree with this assessment, though we think that Ofgem should monitor the situation for users of Economy 7 meters.

*19. Do you agree with our assessment that this modification is unlikely to lead to any significant impacts on essential services or supply chains?*

We agree with this assessment.

*20. We would note that increases in demand costs will need to be incorporated into the Price Cap methodology. Do you have any views on this area?*

We agree that the allowance in the cap for BSUoS should increase, while allowances for wholesale and low carbon policy costs should decrease.

*21. Do you agree with our proposed implementation date of 1 April 2023? Please provide your reasoning.*

We agree with this implementation date.

*22. Do you have any other information which is relevant to this consultation?*

We have no further relevant information.