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Selection of LDES projects for Window 1 Cap and Floor regime

Centrica welcomes Ofgem's consultation on the approach to project assessment and selection for this first window. We are fully supportive of the work done to develop the Cap and Floor mechanism for Long Duration Electricity Storage projects, and appreciate the work being carried out by Ofgem, to run the window 1 process and develop the new regime in parallel.

Our interest in LDES

As a leading energy producer and supplier, a key part of Centrica's strategy includes development of a portfolio of large-scale, grid connected battery projects. These assets can play an important role in security of supply for GB during times of high demand or reduced system availability. For this application window, we have brought forward two projects (LDES Barry and LDES Roosecote) for the initial assessment of eligibility. We believe both projects align well with the objectives of the Cap and Floor regime and can deliver material benefits to consumers and the wider system.

Our response to this consultation

At a high level, Ofgem has set out a comprehensive and well-reasoned framework for assessing projects. We have provided full responses to the individual consultation questions, for Ofgem's consideration in the Annex below. In this we highlight areas that Ofgem may want to consider, in order to ensure assessments are both fair and accurate, while also accounting for the high number of projects Ofgem is likely to need to assess. We look forward to engaging with Ofgem further as the new framework develops.

Yours faithfully,

[redacted] – ***Regulatory Economics and Policy Team, Centrica***

Annex: Responses to the consultation questions:

Q1. Do you have any views on our overall approach to the MCA, including specifically the proposal to assess the three main areas set out in 2.2?

We support Ofgem's overall approach set out in paragraph 2.2, in that assessing projects against criteria under these three themes, should provide enough detail for Ofgem to enable them to make robust decisions on which projects can receive a cap and floor.

However, while the assessments provide a structured basis for evaluating projects, for project developers it remains unclear how Ofgem will use the outputs of these assessments to determine which projects are ultimately successful. Specifically, greater clarity is needed on how scores across the economic, financial, and strategic assessments will be weighed. We explore this further in the answers to the subsequent questions.

Q2. Do you have any views on our proposed in-the-round assessment that will rank projects based on NPV and then adjust with non-monetary impact will provide a robust result?

Process and timing: For future windows we would prefer Ofgem to publish a target capacity range ahead of the eligibility assessment stage, ideally no later than the date at which the window opens. For the first window we encourage Ofgem to target the upper end of any range, and assuming enough projects have passed the eligibility stage, would support an Ofgem decision to prioritise track one (delivery by 2030) given the immediacy of Clean Power targets.

Approach to ranking: Assuming that significantly more capacity is looking to secure a cap and floor than will be required by Ofgem's target, we recognise an element of ranking will be required. Ideally, this process would be transparent for developers and Ofgem will set out a clear methodology on how projects will be assessed and how scores across the economic, financial and strategic assessments will feed into a decision on whether a project can be awarded a cap and floor.

As summarised in paragraphs 2.5 to 2.9 of the consultation document, it is not clear how these decisions will be made, and there are potential risks with some of the processes set out in the summary.

Ultimately the best projects will be those that perform reasonably well across all three assessments and demonstrate a relatively high confidence level associated with their estimates. When making final decisions we believe it is reasonable to want to avoid projects that:

a) Perform poorly across all assessments
b) Score highly in a single assessment but poorly in others
c) Projects where there is a significant lack of confidence in the estimates provided for assessments relative to other assessments

As currently described in the consultation, we believe there is a risk that the methodology could favour projects that perform strongly in one assessment area but poorly in others, while still achieving a high overall score. This risks distorting the outcome in favour of projects that may look appealing on a single metric, for example a project that ranks highly on the economic assessment but carry significant weaknesses in the strategic assessment. A more balanced approach would guard against this by ensuring that no single metric disproportionately outweighs the others in the final evaluation.

In addition, the current approach where Ofgem establishes a ranking based on the economic assessment, and a separate ranking based on the financial assessment may be less effective in cases where there is limited variation in project scores within a given assessment. For example, if most projects achieve broadly similar results in the financial case, the ability to meaningfully differentiate between them based on this ranking is reduced. This could lead to final outcomes being overly sensitive to minor scoring differences or to subjective judgments in the other categories.

To help address this, we suggest Ofgem considers the benefit of introducing minimum threshold criteria for each of the three assessments, or at least the economic and financial assessments where Ofgem uses these assessments to produce rankings. Projects could be required to meet a baseline standard in all areas before being ranked. This would help ensure that well-rounded, credible projects proceed.

Ensuring transparency: We would welcome further clarity on how Ofgem will determine which non-scored elements will influence project rankings and how. It is currently unclear what would be considered sufficient to affect outcomes, and how a framework will be established to ensure judgments will be applied consistently.

Q3. Do you have any views on using competitive bids - based on project-specific parameters - to inform the financial assumptions and C&F levels in each project's assessment? How might this approach work on a technology neutral basis?

We are generally supportive of the proposal to allow developers to use competitive bids, based on their individual project parameters. This is preferable to a uniform administrative model. We will provide our more detailed positions on Ofgem's approach to the financial framework in our response to Ofgem's separate consultation on this area.

Q4. Do you agree that some revenue streams - such as from re-optimisation or ancillary services - cannot be fully captured in the Economic Assessment? How could NESO or Ofgem better account for or validate these in the assessment process?

We are aligned with Ofgem's view that it may be difficult for some revenue streams (specifically from re-optimisation and ancillary services) to be fully captured in the economic assessment. If the extent to which this is covered in the economic assessment is consistent across all projects, from a fairness perspective this would be acceptable. However, in the consultation Ofgem refers to a qualitative assessment for this criterion. We would welcome clarity on what this entails, and how this translates into scoring under the economic assessment. While future revenue streams arising from provision of ancillary services may be hard to quantify, this is a key system benefit that some LDES projects can provide, and it is important that Ofgem reflects this suitably in its approach to the assessment.

Q5. Are we considering the right impacts for the Economic Assessment, and have we correctly characterised both monetised and non-monetised impacts?

Ofgem set out a suitable and comprehensive set of impacts that will be covered in the economic assessment, and we do not believe that any significant category has been overlooked.

Regarding how each criterion is considered in the assessment, where these are classed as non-monetised impacts Ofgem should set out clearly how these will be scored, including the basis on which this score would be used to adjust a project's ranking.

When considering 'Capacity Market impacts', we would welcome further clarity on what Ofgem envisages being assessed in this instance. An accurate assessment, for example, of the impact of an individual project on clearing prices may be difficult to reliably determine and be of limited use to an assessment.

Q6. Are there important system-level benefits from LDES that are not well captured in the Economic Assessment but could significantly impact outcomes? If so, what are they, and can they be consistently assessed across projects?

There are no additional system benefits we wish to flag, that aren't already captured underneath the economic assessment or the strategic assessment.

Q7. Do you have any views on the relevance, appropriateness and completeness of the impacts proposed in the Strategic Assessment?

We recognise the strategic assessment will be important in ensuring Ofgem is able to make a full and fair assessment of a potential project. Regarding the proposed impacts that would be considered in the assessment:

When considering 'flexibility' as described in paragraph 4.10, we do not think this assessment needs to extend to "plausible future scenarios that have not been explicitly modelled within the assessment framework". This risks undermining transparency and potentially overcomplicates this element of the assessment as it is unclear which scenarios would be appropriate to consider here that would not have been modelled elsewhere. In this instance, we would suggest Ofgem only considers flexibility in performance against scenarios which have been modelled in the economic and financial assessments.

For 'option value' we think consideration of optionality around project extension to be a key benefit that should also be assessed here. Assets which can potentially extend beyond their original planned life may be of higher strategic value and add to long term resilience. It may also be useful to consider more explicitly, the potential weaknesses with regards to optionality. For example, Ofgem highlights a potential scenario where multiple PSH projects sharing the same water resources impact each other's scope for expansion in the future. In this example, we assume there would also be a more inherent risk regarding availability of resources necessary for the normal operation of the projects, that should be considered in the strategic assessment in addition to questions regarding future expansion optionality.

On the 'need for a cap and floor' we agree this should be considered as part of the strategic assessment, however, would welcome further clarity on how Ofgem would judge this. Ideally this element should provide a binary yes/no conclusion to be scored as part of the wider assessment. We also believe this element should be nuanced as projects that may be viable without a cap and floor should not be considered as fully merchant, given they would likely seek support through the Capacity Market. Accordingly, the question should be – 'could the project proceed without a cap and floor' rather than 'could the project proceed on a purely merchant basis without regulatory intervention'.

Q8. Are there other impacts that we should be considering in the Strategic Assessment?

While location will already be covered to some extent in the economic assessment, we believe there is also a case to consider locational benefits as part of the strategic assessment. This could include considering if and to what extent a project aligns with regional spatial planning objectives.

Q9. Do you have specific suggestions for how the Financial Assessment output should be considered alongside the Economic Assessment?

As described in paragraph 5.32, we recognise there is a potential inconsistency with how Ofgem will consider the outputs of the Financial Assessment, and how it will assess projects as part of the Strategic Assessment.

Ofgem states that the Financial Assessment will illustrate whether a project appears "financially viable" and that "if a project is expected to operate mostly at the floor, it is important to consider whether the regime will still drive efficient behaviour and deliver good outcomes for consumers".

This infers that projects expected to operate closer to the floor would perform less favourably under this part of the assessment, than projects operating well in excess of the floor and closer to the cap. This appears to conflict with the elements of the strategic assessment set out in paragraphs 4.11 and 4.12 where Ofgem is looking to consider whether a project could proceed without a cap and floor.

From the strategic perspective the most 'valuable' projects may not be those that generate the highest revenues and consistently operate well in excess of the floor. Such projects may also be the ones less likely to proceed without a cap and floor.

Furthermore, we believe it is important to explicitly consider whether the regime will drive efficient behaviours and good outcomes for all projects, not just those operating near the floor. In any case projects operating near the floor may arguably face a stronger incentive to behave efficiently than projects expected to operate nearer the cap, given those nearer the cap would face a weaker revenue incentive to drive marginal gains. In addition, we would welcome clarity on whether Ofgem intends to apply a consistent approach to evaluating and comparing applicants' financial model assumptions. Given that projects will inevitably use different market views (e.g. P50 vs P70, bullish vs bearish price forecasts), there is a risk that face-value comparisons could favour outliers whose assumptions may not be fully justified. Without a normalised baseline or benchmarking process, there is a risk that projects could be mis-ranked in terms of financial viability.

Q10.Do you agree with our proposal to assume that LDES projects will remain revenue neutral following balancing market actions?

We do not agree this will be a suitable assumption for all projects. Some LDES technologies may be able to operate as flexibly as short duration BESS and therefore may be revenue positive after balancing market actions. Assuming neutrality could undermine the value of such projects and disadvantage these in the Financial Assessment, relative to other projects.

Q11.Do you have any views on the proposed Marginal Additional method and whether it provides a robust basis for assessment?

On balance, we prefer the approach outlined in this consultation to what was considered previously, as it provides a more consistent benchmark across all projects, better enabling objective comparisons.

Q12.Do you have any views on the counterfactual to use for this assessment and sensitivities that we could use?

We do not have views on an alternative counterfactual.