

**BSC Modification Assessments P198, 200, 203 and 204 – Ofgem’s “minded to” statement**

The CHP Association disagrees with the Authority’s “minded to” (or draft) decision to accept P203, but agrees with its proposed rejection of modifications P198, 200 and 204. Together with a large majority of the industry, including many CHP operators, we do not believe that Ofgem has shown that P203 better facilitates achievement of the applicable BSC objectives or its wider statutory responsibilities, its assumptions about changes in behaviour are flawed and it has taken insufficient account of a number of detrimental aspects of the proposals.

We have addressed the specific questions raised by Ofgem in the appendix to this letter. This covering letter makes some general points that are directly relevant to our membership.

The Authority’s “minded to decision” fails to address the impact of the proposals on large CHP operators as a class of participant. Economic signals can only work if market participants are able to respond to them. However many existing CHP operators that are transmission-connected are located to suit demand needs on existing industrial sites and cannot respond to new locational costs in the market. Given these installations tend to be remotely situated they will simply see a new cost, which is essentially a tax. The “minded to” letter fails to acknowledge these issues and their discriminatory impact.

In terms of capacity, the regions of Scotland, Yorkshire/Humber, the North West and the North East of England—which would be impacted most adversely by the modification proposals—account for well over 2/3rds of currently installed CHP capacity. The proposed changes would thus result in less competitive generation from most of the CHP sector further undermining its ability to compete fairly and destabilising its targeted growth. It is highly undesirable, given the vast quantum of sunk investment, to create such incentives, especially given the beneficial environmental impact of such installations.

There were significant flaws in Ofgem’s regulatory impact assessment (RIA) that have not been corrected. The further analysis presented with the draft decision addresses some of the deficiencies but it remains far from complete. Ofgem has not shown why the behavioural changes it assumes will arise, and as a consequence the large part of the redespach benefits (and accordingly the carbon savings assumed on the back of them) will simply not arise. Above all the assessment and supporting analysis taken as a whole leaves the impression that had the timeframe been extended to cover a period more compatible with industry investment timescales (e.g. fifteen or more years, typically longer in the case of CHP), which regulatory good practice suggests it should have done, the overall net benefit alleged would have been negligible if not negative.

Compounding this, the considerable upheaval inherent in P203 the modification proposals heavily exceeds the modest potential gains identified in the RIA, many of which we feel are over-stated, and we consider there is great scope for unintended consequences and detriments that has not been acknowledged.

The British electricity market design already incorporates strong locational signals through National Grid’s transmission network use of system (TNUoS) charges, and Ofgem has not demonstrated why it considers these inadequate. The inherent instability in the TNUoS charging

signal separately warrants consideration, as does the distorting effect arising from the costs of existing transmission constraints, and they both have important interactions with the current change proposal but have not been properly explored.

The additional analysis included in the proposed decision showing there is no over-signalling is wrong because it fails to recognise that there is an additional cost of transmission losses that relates to the fixed portion of these costs, which are unavoidable. There are also inherent inconsistencies between the cost signals in some TNUoS zones relative to the variable losses charge, and there is also a distorting effect in that well-situated generators within high cost zones will be penalised. Ofgem has also failed to explore the inherent scope for asymmetry between factors set ex ante and the “correct” costs that would have arisen ex post.

Finally gas operators, including many CHP operators, will see conflicting signals between the variable losses charge and the gas transportation fees they pay (which further undermine Ofgem’s assumptions about behavioural response).

Please let me know if I can provide any further comment.

**Phil Piddington**

## CHAPTER: Two

**Question 1:** Do respondents consider that we have appropriately summarised the key themes of the responses to Ofgem's impact assessment on zonal losses?

**No. This does not address the discriminatory impact on many CHP operators. There are also differential impacts for integrated and portfolio players versus those that are not.**

**Question 2:** Are there any other themes which respondents considered should have been highlighted?

**As above.**

## CHAPTER: Three

**Question 1:** Do respondents consider that the additional analysis we have provided addresses the concerns expressed by respondents to the impact assessment regarding analytical gaps in the impact assessment?

**It addresses some of them. As noted in the cover letter we think the analysis on scope of locational signalling is not accurate, and interactions between TNUoS and the gas charging regime have not been properly identified and assessed.**

**Question 2:** Do respondents consider that there are any remaining aspects on the modification proposals that require to be addressed analytically?

**Behavioural issues under the Neta market structure need to be addressed. There are other factors that will determine the operational decisions of parties. CHPA considers that most redespach benefits that have been assessed will be unlikely to arise in practice. Consequently the environmental benefits also will not materialise.**

**Further at no point does Ofgem address impacts on consumer prices as new costs will be passed through but savings will not, or the possible impact on market entry.**

**Question 3:** Do respondents have any additional analysis in relation to the impact of the modification proposals that they wish to bring to the attention of the Authority?

**No.**

## CHAPTER: Four

**Question 1:** Do respondents consider that the modification proposals have been appropriately assessed against the applicable BSC objectives?

**No. The efficiency benefits are over-estimated, and the competitive effects not properly explored. There is also a detriment in terms of efficiency of the BSC arrangements.**

**Question 2:** Do respondents consider that there are any aspects of the modification proposals that have not been adequately assessed in relation to the applicable BSC objectives?

**There is no assessment of the impacts on different types of party.**

## **CHAPTER: Five**

**Question 1:** Do respondents consider that the Authority has appropriately assessed the modification proposals against the applicable BSC objectives when considered collectively?

**No. In combination, when properly weighted, we consider there to be a net disbenefit from P203.**

**Question 2:** Do respondents consider that there are any aspects on the modification proposals that have not been adequately assessed in relation to the applicable BSC objectives when considered collectively?

**As above.**

## **CHAPTER: Six**

**Question 1:** Do respondents consider that the Authority has appropriately assessed the modification proposals against its duties?

**The environmental aspects cannot have been considered properly as it does not consider impacts on low carbon technology such as CHP. There is also no mention on the impact on barriers to entry in the market, which we consider overall detrimental.**

**Question 2:** Do respondents consider that there are any aspects on the modification proposals that have not been adequately assessed in relation to the Authority's duties?

**As above.**

## **CHAPTER: Seven**

**Question 1:** Do respondents have any comments on any of the issues set out in this chapter?

**No.**

## **CHAPTER: Eight**

**Question 1:** Do respondents wish to raise any specific issues regarding the Authority's minded to position?

See covering letter.

**Question 2:** Do respondents have any views on both the process and timetable that are proposed for the Authority making its final decisions on the modification proposals and for publishing those decisions?

**No.**