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Alena Aliakseyeva
Ofgem
Millbank
London

Our Ref: GS-001640

15 January 2014

Dear Alena Aliakseyeva,

Re: RES Response to on Impact assessment on CMP201 - proposal to remove balancing charges from generators

RES is one of the world's leading renewable energy developers working across the globe to develop, construct and operate projects that contribute to our goal of a sustainable future. We have a portfolio of low carbon energy technologies and a range of services which together can meet demand from the industrial, public and commercial sectors on any scale.

RES has been an established presence at the forefront of the wind energy industry for over three decades. Our core activity is the development, design, construction, financing and operation of wind farm projects worldwide. RES has developed or built almost 8GW of wind energy worldwide and we have several thousand megawatts under construction and in development, we continue to play a leading role in the world's fastest growing energy sector. RES is also involved in the dedicated biomass, solar, offshore wind, wave and tidal sectors.

RES welcomes the opportunity to respond to the Impact assessment on CMP201 - proposal to remove balancing charges from generators. We attach our response to the specific consultation questions and the key points to note in our response are outlined below:

1. We do not agree with the initial assessment and Ofgem's "minded to reject" position. The entire assessment of the proposal is positive towards adopting the change apart from the cost to consumers. The whole decision appears to rest of the assumption of increased cost to consumers, it is therefore very disappointing that Ofgem has decided to ignore factors such as raised incentive to invest, decreased reliance on capacity market and the effects of market coupling (a market measure that Ofgem claims to support). RES would therefore encourage Ofgem to revisit their analysis and consider these factors in more detail before arriving at its conclusion on the long term cost to the consumer.

2. Ofgem's core argument seems to be that GB energy exports will become more competitive thereby eroding domestic wholesale competition giving rise to increases in domestic prices. Ofgem seems to be concluding this price rise would occur in isolation and no other GB energy market effects would be realised. This seems a highly flawed assumption.

3. Overall, more analysis needs to be undertaken by Ofgem and NGET. The analysis presented in the consultation is too simplistic and does not consider sufficient variables to be considered robust. It does not appear that the modelling in this consultation has looked at the wider European market.

RES are grateful for the opportunity to comment and look forward to your response and final decision on whether to approve or reject the proposal early next year. We hope you take our comments on board and welcome any further contact in relation to this response. To do so, please contact Sarah Husband at Sarah.Husband@res-ltd.com or 01923 299 454.

Yours sincerely,

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Consultation Questions

Chapter 3: Impact of CMP201

Question 1: Do respondents consider that we have identified the relevant impacts of the CMP201 proposal?

We do not believe that all the relevant impacts have been appropriately considered as regardless of whether generators and/or suppliers are required to pay the BSUoS charge, it will still be the same total charge that will need to be recouped via consumers. As discussed in response to question three below, the modelling is flawed as it does not consider the effects in Europe appropriately as the European market assumptions appear to remain static.

The impact on industry contracts is discussed in point 2.5 of the consultation:

> "*If CMP201 is implemented, some of these contracts will not be adjusted immediately to reflect changes in BSUoS charges – the generator's BSUoS forecast will still be priced into the contract. This leads to creation of winners (generators) and losers (suppliers) in the transition period, before contracts can adjust. Similarly, it is not clear how much of this increase in cost the supplier can pass on to the consumer in the short run.*"

Also, point 3.6 in the consultation states that:

> "*Suppliers may be locked into existing contractual arrangements, preventing them from passing through the BSUoS cost to consumers.*"

However, any changes to BSUoS will not be implemented straight away; a reasonable notice period would be applied. Such practice has been adopted by Ofgem in deliberating over a decision on CUSC Modification Proposal (CMP) 213 (Project TransmiT). Assuming a two year implementation period, April 2016 would be the earliest possible implementation point. In light of this, it seems likely that generators will not be immediate winners and are unlikely to be winners at all. It is likely that existing PPA contracts would have change in law clauses and could be re-opened if BSUoS is specifically defined in the PPA. Furthermore, there are a limited number of supply contracts longer than two years and some of those which are longer than two years may well have BSUoS as a pass through cost given that there is a real possibility that the charging structure will change.

Question 2: Do respondents have any quantitative or qualitative evidence on the likelihood of additional investment in generation that would offset the relative increase in wholesale prices?

We have no specific evidence to add but would note that an increasingly uncertain investment environment for renewables, the removal of an uncertain charge such as BSUoS from the economic model of future renewables projects is only likely to help improve investor confidence.

Question 3: Do respondents have any further evidence on the effect of CMP201 on supplier credit risk.

It is for suppliers to respond to this question. However, we believe that suppliers will be able to pass this additional risk on to consumers as they will have at least two years warning of any changes. As discussed in response to question one above there are not many supply contracts for longer than two years and some of those which are longer than two years may well have BSUoS as a pass through cost given that there is a real possibility that the charging structure will change.

Ofgem assert in the consultation that BSUoS charges may not be passed through to consumers because of the form of wholesale contracts between suppliers and generators. This seems highly challengeable and inconsistent with subsequent reference to BSUoS as a “pass through charge” (page 13). Does Ofgem have evidence to suggest that BSUoS is always incorporated into the wholesale price and that there is no provision within contracts to permit variation to reflect change in industry rules and charging? We believe that such contract terms are likely to be common place in wholesale contracts.

Chapter 4: Initial Assessment
Question 4: Do respondents agree with our initial assessment of the proposal?

We do not agree with the initial assessment and are unclear as to how the “minded to reject” position has been reached. The areas of the Ofgem assessment with which we disagree are outlined below:

a. Analysis

Overall more analysis needs to be undertaken by Ofgem and NGET. The analysis presented in the consultation is too simplistic and does not consider sufficient variables to be considered robust. It is stated in the executive summary of the consultation that:

> “*Due to effects on the supply of electricity in GB, the decrease in GB wholesale price is not equivalent to the reduction in generators’ costs associated with the removal of BSUoS charges. Specifically, the reduction in a generators wholesale price increases demand from Europe and this in turn increases net export from GB to Europe across the interconnectors.*”

However, under supply and demand cycles the increased demand led by the cheaper power will ultimately increase the price of the power in the long run and less will be exported. Ofgem’s core argument seems to be that GB energy exports will become more competitive thereby eroding domestic wholesale competition giving rise to increases in domestic prices. Ofgem seems to be concluding this price rise would occur in isolation and no other GB energy market effects would be realised. This seems a highly flawed assumption. The effects of increased investor confidence through generators having a more competitive position in a cross European market does not appear to have even been considered in this consultation.

Additionally, point 4.8 of the consultation states that “interconnectors can flow against market price for up to 32% of the time”, therefore if this is the case, why is it assumed that the removal of BSUoS will give rise to increased exports and therefore a raise the domestic wholesale prices but without increased future generation investment?

Also, under this scenario, prices would become more comparable across Europe and the point will be reached when prices converge. This is the aim of market coupling and what Europe is striving for. Additionally the executive summary also states:

> “*In response to the increased demand for GB generation, more expensive marginal (carbon) generators will switch on to meet total demand – ultimately increasing the GB wholesale price.*”

It is unclear why Ofgem are assuming that extra (more expensive) generation will always be needed. One of the key rationales for raised interconnection between EU Member States is to permit increased reliance on intermittent generation through cross border trade. Ofgem’s statement above seems to run counter to this position. Also, if renewables were not being exported from GB, Europe would need to resort to higher carbon generation. Assuming, market coupling has the intended effect, the overall impact to Europe would be equal.

There is also a financial benefit to existing GB generators through exporting to Europe through avoidance of domestic grid related constraint and it is unclear whether this benefit has been considered. The benefit to existing generation is talked about in terms of investment but if existing plant is not utilised or renewable generation is curtailed then there is ultimately a cost to the GB consumer for that wasted energy potential.

It does not appear that the modelling in this consultation has looked at the wider European market. Also, it is unclear how the claims of "between £2 and £2.50 [increase] on the average annual domestic consumer bill" were established. Point 3.16 of the consultation states:

> *"The model is static. If the impact of CMP201 is limited to the short-term effects described above, consumer bills will remain £2-£2.50 higher in every year following the implementation of the proposal."*

Therefore, the impact is similar if as stated in point 3.22:

> "*It should be also noted that, by extension of the principle, if other EU states adopted the GB position (i.e. charging BSUoS to both generators and suppliers), the impact on GB consumers would be broadly similar. That is, if BSUoS is imposed on EU generators currently exporting to GB, they will pass that additional cost to GB consumers through higher wholesale import prices (unless they choose to absorb the cost, rather than pass it on).*"

Therefore, the second point appears to contradict the "minded to reject" position of this proposal as it highlights that the effect is neutral if all markets align.

b. EU Compatibility

As discussed above, if the cost of BSUoS and other market charges aligns with the rest of Europe, a market distortion will be removed, market coupling is likely to prove more effective and wholesale prices will converge across Europe. As discussed in our response to question five below, it is unclear why Ofgem have ignored this theory, particularly in light of its statement in the consultation that "*we are fully committed to an integrated European electricity market.*" Specifically, the consultation describes in some detail the market distortions that would prevent the GB market realising full value for its more increased competitive decision and uses this as partial justification for a minded to reject position but in doing so it perpetuates an existing market distortion.

If costs in GB do not align with the rest of Europe it will make generators in GB uncompetitive, it will also not enable the full capability of interconnection to be achieved between the EU and GB as GB will always be more expensive. For example in Ireland, a country with which there is significant existing and proposed interconnection, BSUoS charge equivalents are referred to as Imperfection Charges and are recovered from demand customers.

Additionally it seems highly likely that GB will have to align with all European charging methods at some point in order for the EU Target Model to function. As discussed in point 1.7 and 1.8 of the consultation, GB has previously been required to remove BSUoS charges from interconnector flows. Therefore, we see no reason in delaying the charges required to BSUoS charging upon generators.

c. Investment in New Generating Capacity

As stated in the executive summary of the consultation:

"*In the longer term, if investment responds to market signals, it is expected that the negative impact on consumers will reduce. This is because greater investment in GB generation will in time increase production, exerting a downward pressure on the wholesale price.*"

Increased investment in GB generation will increase supply margin and reduce the need and cost to consumers of a capacity mechanism in the GB market. This variable and ultimate impact has not been considered appropriately by Ofgem in its assessment.

d. Relevant Objectives

A summary of Ofgem's assessment before reaching "minded to reject" position is outlined below:

a) **Competition** – "*Our initial view is that the removal of the BSUoS charges from generation allows GB generators to compete on a more equal footing with European generators (point 4.9).*" And "*4.12. In light of the above, our initial view is that the impact of redistribution of costs from GB generators to GB suppliers on competition in our domestic electricity market is neutral (point 4.12).*"

b) **Cost Reflective** – "*our view is that the proposal is neutral when assessed against Relevant objective (b) – i.e. that charges should reflect, as far as is reasonably practicable, the costs (4.23).*"

c) **Business Development** – "*Our initial view is that CMP201 marginally better facilitates the development of the transmission businesses across Europe (4.25).*"

d) **Statutory Duties** – "*As discussed above, it is our view that approving the implementation of CMP201 does not better facilitate the Authority's statutory duties, as the benefits of increased competition and increased EU integration may not be realised. In addition, there is a risk that the near term adverse impact of the CMP201 on GB consumer prices may never be fully offset by increased investment in GB generation in the longer term (4.50).*"

The entire assessment of the proposal is positive towards adopting the change apart from the cost to consumers. As the whole decision appears to rest on the assumption of increased cost to consumers, it is therefore very disappointing that Ofgem has decided to ignore factors such as raised incentive to invest, decreased reliance on capacity market and the effects of market coupling (a market measure that Ofgem claims to support). RES would encourage Ofgem to revisit their analysis and consider these factors in more detail before arriving at its conclusion on the long term cost to the consumer.

Question 5: Are there other relevant factors that respondents consider we should take into account?

Wider review of the differences in charges between EU Member States is needed alongside a wider review of the impact of removing BSUoS as discussed in response to questions one and four above. This is a small part of all other charges in Europe which need to align to facilitate fairer market trading across Europe.