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16 January 2014

Dear Alena,

Impact Assessment on CMP201 – proposal to remove balancing charges from generators

Thank you for the opportunity to respond to the above impact assessment.

ScottishPower is disappointed at Ofgem's "minded to" decision to reject CMP201 as this will maintain barriers to GB generators trading with the European electricity market and will perpetuate the competitive distortion inherent in CMP202 (which removed balancing charges from interconnector users).

We believe that a decision to reject CMP201 would be at odds with the aims of the EU "Third Package" and the European Electricity Target Model as it would not facilitate efficient competition between generation in GB and in the wider EU electricity market.

Furthermore, Ofgem's position does not appear to recognise the well-established economic principle that free trade will benefit all parties involved: in effect it is proposing to maintain an uneven playing field in order to restrict the export of electricity generated within GB with the apparent aim of holding GB wholesale prices below the efficient level. Were Ofgem's decision to be subject to an appeal, we think that this is a position which would be difficult to defend.

With the prospect of large amounts of Irish renewable energy entering the GB market under the MoU recently signed between the respective governments¹ it is even more important that a level playing field is secured for GB generators. The effect of this "minded to" decision, together with Ofgem's proposals for the treatment of GB transmission costs incurred by non GB generation,² could be to preferentially direct consumer renewable subsidies from UK generators to those in Eire. We do not consider this to be an efficient outcome.

We believe Ofgem has placed undue emphasis upon the numerical accuracy of the analysis carried out by the CMP201 workgroup. The Workgroup stressed that "the

¹ Enabling access to CfDs by Eire generators

² <https://www.ofgem.gov.uk/ofgem-publications/84494/regulationtransmissionconnectingnongbgeneration2.pdf>

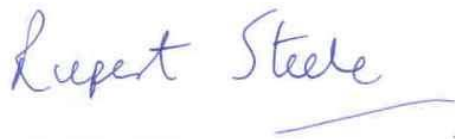
model cannot provide precise numerical impact” but that “the analysis model correctly modelled the likely convergence of markets arising from this proposal” and that “the ‘value’ of the model is in isolating and demonstrating the proposal’s effect and underlying market trend”³.

We believe that the proposed solution in CMP201 addresses the defect identified in the current arrangements and agree with Ofgem that the solution better meets the applicable CUSC objectives. However, we do not believe that the existence of other factors influencing European electricity market convergence and outwith the control of CUSC parties is sufficient justification for Ofgem to reject this modification proposal. Such factors should be addressed through the appropriate mechanisms *in addition* to implementing the solution proposed under CMP201.

Our responses to the detailed questions contained in the impact assessment are attached in Annex 1.

Should you wish to discuss any of these points further then please do not hesitate to contact me.

Yours sincerely,



Rupert Steele
Director of Regulation

³ CMP201 CUSC Modification Report, Workgroup Conclusion

**IMPACT ASSESSMENT ON CMP201 – PROPOSAL TO REMOVE BALANCING
CHARGES FROM GENERATORS**

SCOTTISHPOWER CONSULTATION RESPONSE

Chapter 3: Impact of CMP201

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

ScottishPower believes that the qualitative impact on GB generators has correctly been assessed as positive as they will be able to compete more effectively in EU electricity markets. We do not consider that the qualitative impact on GB suppliers has been properly assessed in the impact assessment.

With regard to the points made at paragraph 3.6 of the condoc, the CMP201 proposal offers a number of implementation dates which would ensure that material impact from any existing end user contracts would have expired and therefore not disadvantage suppliers. We also do not believe that suppliers face a different risk from BSUoS volatility than generators as there is no correlation between a generator's exposure to BSUoS charges via market share and its share of balancing services revenues (including constraint payments). As BSUoS charges are only known *ex post*, they do not provide a signal to which a generator can take mitigating action in the balancing mechanism.

Finally, while Ofgem has considered that “uncertainties and distortions could impact on the benefit being realised” from improving the efficiency of trade within the EU as a whole, Ofgem does not appear to have considered the impact of the Carbon Price Floor which will make GB generation increasingly uncompetitive with other European generators thus reducing potential export volumes and allowing imports to increase. In addition, no account has been taken of the benefits that would accrue from implementation of CMP201 through the delayed closure of existing plant/ investment in new build which would help maintain plant margin and improve security of supply in the short/medium term reducing the need for the procurement of additional reserve by other means such as Strategic Balancing Reserve (SBR) or Demand Side Balancing Reserve (DSBR).

At a higher level, we think it wrong, as a matter of principle, to consider that maintenance of a distortion to competition (charging BSUoS to GB but not overseas generators) can lead in the long term to an improvement in welfare or efficiency. Subsidising imports (or charging extra on exports) will lead at the margin to inefficient levels of investment that are unlikely to benefit consumers. Accordingly, any benefit to consumers from creating artificial over-supply by taxing exports is likely to be short-lived and counterbalanced by disadvantages elsewhere in the economy.

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?

As outlined above, we have serious doubts about the validity of this kind of calculation. In any event, the analysis carried out by the Workgroup (contained in Annexe 13 of the Modification Report) indicates that “introduction of 500MW to 1,000MW of either base or mid-merit generation brought the total market cost down to a level comparable with, or lower

than that of the pre-proposal (base-case) scenario". This indicates that investment in only a single new generation plant could deliver the benefits required to offset any increase in wholesale prices arising from removing barriers from GB generators competing in the European electricity market.

The National Grid TEC Register⁴ indicates that a significant volume of conventional generation is ready to connect in the near future should the correct investment signals be delivered (including removal of BSUoS). In the calendar years 2014 to 2019 respectively, the following volumes of GGCT plant hold connection agreements; 952MW, 500MW, 3,930MW, 5,891MW, 2,864MW and 3,000MW. Of the total of 17.1GW, 9.9GW is either under construction or holds consent for development, indicating that the indicated benefits from additional investment in GB generation could be delivered in the short to medium term.

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

Based upon the analysis presented in Annex 10 of the Final Modification Report, ScottishPower agrees that if CMP201 was implemented within the proposed implementation timescales, any affected supplier would have sufficient time to arrange adequate credit cover and there would be no overall impact on supplier credit risk.

Chapter 4: Initial Assessment

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

We disagree with Ofgem's initial assessment of CMP201. The CMP201 Workgroup agreed with National Grid that there is a defect in the existing charging arrangements for balancing charges. The solution identified by the Working Group, the removal of balancing charges from GB generation, addressed and resolved the defect identified in a way which was within the existing vires of the CUSC governance arrangements.

Ofgem has identified issues around potential future market splitting, and EU tariffication guidance together with factors such as the carbon price floor and differing taxation regimes in EU countries which could impact the delivery of the benefits identified in CMP201. However, such factors are not within the scope of CUSC governance. CMP201 can only address the defect identified within the CUSC arrangements. The existence of further areas of non-convergence of EU electricity markets should not be taken as a reason to reject the changes which it is within the power of CUSC Parties and Ofgem to address and which if implemented would remove a significant barrier to trade for GB generators.

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

We are not aware of any other factors which should be taken into account.

ScottishPower
16 January 2014

⁴ National Grid TEC Register 21 October 2013
<http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/tectrading/tecregister/tecregister.htm>