

23 September 2016

Frances Warburton
Partner
Ofgem
9 Millbank
London SWP 3GE

Dear Ms Warburton,

We are writing to set out our views on Ofgem's open letter regarding charging arrangements for embedded generation dated 29 July.

FCC Environment currently generates almost 500 GWh per year of electricity through Energy from Waste (EfW), providing 0.5% of the UK's renewable electricity for which it receives no Renewable Benefits.¹ This technology plays an important role in supplying stable baseload to the Distribution Network by recovering energy from material that would otherwise be wasted, and in diverting residual waste from landfill and thereby reducing GHG emissions.

We understand that in a changing landscape, charging arrangements for the transmission network must be reviewed and this may result in changes to Embedded Benefits received. However, we are concerned that Ofgem does not understand some of the complexities involved in making changes.

Impact

We have estimated that we receive in the region of £3m a year in TNUoS demand residual payments alone and rely upon these monies as an important element in the mix that makes up our already stressed guaranteed electricity revenue supporting financing these projects over their typical 25 year project life. A removal or significant reduction in these payments would be an additional blow to the sector after the removal of LECs last year. It will also have a potential knock-on effect on gate fees where applicable through Change in Law mechanisms, the increased costs of which will largely be taken on by Local Authorities to fill the funding gap to these projects. Local Authorities are already struggling to maintain their services with shrunken resources, and this added burden will mean that waste management will have to compete with frontline services for scarce funds. Where Change in Law is not applicable this will place further risk on Project Financing with the real possibilities of projects starting to default and fail through not meeting cover ratios

¹ Calculations based on BEIS (2016), [*Digest of United Kingdom Energy Statistics*](#), p.192

On top of this, investor confidence in the industry will wither. Our industry is heavily reliant on private finance to fund new projects and for reinvestment into existing projects. Investor confidence has already been eroded by low electricity prices and further dipped due to the removal of LECs, and now Brexit. A stable and sensible charging regime is essential for the industry to attract investment which will ensure we can continue to work towards delivering the future power needs of the UK.

Ofgem's approach

FCC Environment is concerned therefore that Ofgem has not understood the complexities of the situation and is in danger of rushing through clumsy changes. The timescale proposed of implementing changes before 2019/20 is far too short to make such a radical change that will have serious consequences for industry.

We are particularly concerned that Ofgem has not accounted for additional complications brought about by the EU referendum result. If changes are brought in before the UK has exited the EU, they may come into contention with EU rules on state aid. There will also need to be an assessment on the impact of the changes on interconnectors across Europe and how this is affected by Brexit. We would therefore like to see this review included in Brexit discussions, which would necessitate a longer review process and later implementation date.

On top of this, Ofgem should evaluate different types of embedded generation separately to avoid broad changes that create an imbalance in the UK's energy mix and whether these generators receive other Renewable Benefits that support their financing. Unlike many other forms of embedded generation, electricity generated by the Energy From Waste industry is baseload and receives no Benefit. It plays a crucial role in generating electricity at all times, contributing to security of supply. The benefit of responsive and embedded baseload generation, such as that provided by EfW, should be recognised in Ofgem's review.

We also dispute the five reasons that the TNUoS demand residual payments may be distorting the market cited by Ofgem (p.5):

- In our opinion, any mix of generation should include a proportion of reliable and controllable renewable energy, such as EfW. Although we are small in comparison to transmission connected generation (TG), our business is evidence of a cost effective and efficient use of wastes.
- Given the economies of scale of TG and the link between power prices and their fuel input costs, we do not believe our operations or entitlement to embedded benefits has resulted in TG exiting the market, moreover this is happening due to legislation such as the Large Combustion Plant Directive (LCPD).

- We do not agree with your concern over distorting despatch. Moreover, the dampening of prices at peak times is something that Ofgem should support in the interests of reducing consumer bills.
- Similarly, if the Capacity Market is being distorted through embedded generators being able to bid at a significantly lower price, then this is positive for the market and consumers.
- In respect of your final point, innovation is often driven by potential financial reward, be that embedded benefits or other market support mechanisms (such as the Capacity Market or CfDs). If Ofgem wish to stifle innovation it can remove any number of incentives in order to do so. Further, we do not believe that our access to embedded benefits is preventing TG from innovating.

Modifications

In principle we believe Ofgem should step back from the position indicated in within their Open Letter and consider the implications further however if immediate change was inevitable we prefer a split implementation grandfathering approach. Making changes that affect existing contracts (as put forward in CMP265) would be damaging to both investor confidence and jeopardising projects. The FCC Environment has invested billions in the energy sector, has signed contracts in the understanding the embedded benefits would be received and more recently received Capacity Market Agreements for projects that rely upon both being in place. Changes must only be introduced to projects going forward and accounting for the energy mix. There should also be a split implementation approach that recognises the differences between intermittent and baseload generation.

However, as discussed previously, these changes should not be rushed through, and their full impact should be carefully assessed.

Conclusion

FCC Environment is concerned that Ofgem does not fully understand the complexities of making changes to charging arrangements for embedded generation and their impact on other parties (e.g. local authorities), growth and innovation in the sector enabled by strong investor confidence, and security of supply.

We appreciate that undertaking a Significant Code Review would require a longer time scale, but looking at TNUoS payments in isolation may have unintended consequences for the market. Given that rushed changes could have serious repercussions and that the impact of Brexit must be taken into consideration, we strongly urge Ofgem to reconsider undertaking a SCR. A longer time scale would allow Ofgem to undertake a robust impact assessment that appreciates the nuances involved in making changes.

We welcome the opportunity to discuss these issues further with you and look forward to your response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Steve Brown'.

Steve Brown
Operation Director GE+