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Open letter: Charging Arrangements for Embedded Generation

Falck welcomes the opportunity to comment on the issues raised in Ofgem's Open letter of 29th July regarding charging arrangements for embedded generation.

Falck Renewables S.p.A. and its affiliates (the "**Falck Group**") is an experienced European developer in the planning, construction and management of wind and solar power projects at all stages of their development. Falck Group has a proven track record of successfully developing, constructing and operating wind projects in the UK, Italy, Spain and France with a wind portfolio of 760 MW in operation, 65 MW in construction, and 50 MW of projects in planning.

Formed in August 2002, Falck Renewables Wind Ltd is headquartered in London, and its European operations headquarters is located in Inverness. Our UK portfolio comprises approximately 413MW installed capacity of wind energy with 10 projects currently operating and 2 under construction across England, Scotland and Wales. Of these 12 projects, 10 are embedded projects connected via the distribution network. As one of the UK's largest independent wind farm companies Falck continues to pursue a development pipeline of projects in the UK, France and Poland.

Transmission charging arrangements for embedded generators

We note the breakdown of embedded benefits included in Ofgem's open letter and the identification of TNUoS demand residual as the main element of embedded benefits and its main concern. We acknowledge the concern over the rising level of the demand residual transmission network use of system (TNUoS) tariff and we support action to address the problem. However, we do not support the proposal to tackle this issue in isolation through a CUSC modification. Embedded generation makes an increasingly important contribution to the electricity network and a piecemeal approach that addresses only one part of the arrangements is likely to have a number of serious detrimental or unintended consequences. We also feel that this approach seems rushed and we feel that a wider ranging review is needed so that changes to TNUoS demand residual are not made in isolation but the full range of costs and benefits are considered in order to help create a level playing field for both embedded and transmission connected generation.

The open letter references the DECC Capacity Market (CM) consultation which raised concerns that embedded generation may be over-rewarded by embedded benefits, leading to inefficient outcomes in the Capacity Market. We do not feel it is appropriate to rush through changes in embedded benefits to address

perceived problems in the outcome of the Capacity Market, particularly as over 20GW of existing embedded benefits, which operate outside the Capacity Market, will be impacted.

A fuller embedded benefits review

We are a sponsor of Cornwall Energy's most recent work on embedded benefits and its latest report *Embedded Benefits: Addressing Market Distortions*, which we commend for your attention. We endorse its key finding that a thorough and considered review is vital. Ofgem's current approach focusing solely on the TNUoS residual demand tariffs threatens to damage investor confidence by undermining the basis on which investment decisions have been made in good faith and therefore risks disruption to existing generation as well as future investment.

Going forwards, there is the prospect that hurried and insufficiently thought through change greatly increases the perception of regulatory risk and damages the confidence of investors, which could ultimately have detrimental impacts on security of supply and on progressing the low-carbon agenda. Reducing the value paid to embedded generators would also increase the clearing price of the Capacity Market and thereby increase costs to consumers particularly, given the cost recovery arrangements, domestic consumers and those least able to reduce consumption during the peak periods.

We urge Ofgem to reconsider its position to implement a potentially rapid change through a relatively straightforward CUSC code modification. We would prefer that charges for TUoS demand residual payments be temporarily frozen allowing time for a more comprehensive and holistic review and for changes to be made in a more considered and orderly way.

To facilitate a more comprehensive review we understand that Infinis Energy is proposing a Workgroup Alternative CUSC Modifications (WACM), developed with support from Cornwall Energy, for the current proposals on embedded benefits being considered that proposes to place a ceiling on the level of the residual component of the Triad while the review takes place. This would take the form of a transitional cap which would be in place while this more comprehensive review takes place. We would hope that this should be included in the WACMs that are taken forward for recommendation by the Panel and then determination by Ofgem.

Areas a full review should consider

The Cornwall Energy report highlights a number of areas that need to be considered before any changes are made. These include areas where the value of embedded generation may be understated and where a substantial change to reduce the value of embedded benefits could overbalance the playing field in favour of transmission connected generation:

- the different connections policy between transmission and distribution potentially favours transmission over embedded generation because transmission generation connects under a shallower connection policy and therefore pays lower initial charges. However, this leads to higher TNUoS which feeds into the Triad charging regime. So if the Triad benefit were to be substantially altered without aligning the transmission and distribution connection charging regimes this could provide transmission-connected generation with a cost advantage;
- the potential for the generation residual element of TNUoS to become negative as a result of the cap on generator charges imposed by European legislation and the recovery of local costs for onshore windfarms is a concerning development as it would not be cost reflective and would provide

transmission-connected generation with a cost advantage. We note that Ofgem intends to consider this issue further as part of related work, on which it will set out further thinking in the autumn. However, we do not consider this should be considered as a separate matter as it is likely to be significant and trigger other market distortions but as part of an overall review, in order that the total effect of any changes can be seen; and

- transmission connected generators tend to have full access to the wholesale market and Balancing Mechanism that enables them to achieve an additional revenue stream that is not open to the majority of embedded generators. The impact is to potentially lower its marginal cost and confer an advantage when bidding into the Capacity Market and CfD auctions.

The avoided costs provided by embedded generation need to be much more fully considered. The Cornwall report puts forward various arguments as to why the true local value extends well beyond the current transmission locational charge. One area, for example, is the value of the optionality that is created by connecting embedded generation as outlined in the Cornwall report, and this should be included in any consideration.

In addition National Grid has identified that embedded generation reduces the need for local reinforcement at a GSP. This saving should be identified separately within the charging methodology to increase transparency and cost reflectivity. This could be achieved by splitting out a local charge from the residual to reflect the value to the transmission owner from embedded plant.

Such analysis also needs to be set in the context of the actual level of embedded benefits that generators receive. The level of the embedded benefits which flows through to embedded generators through suppliers, is typically shared with suppliers and this needs to be accounted for in the analysis.

We would also support a review of how the payment of the TNUoS demand residual charge is based on generation during three half hour (triad) settlement periods, as the current mechanism does not incentivise efficient operation of some embedded plant. We understand that proposals have been made at the CUSC panel sessions to base triad payments on a broader period of generation over the 4 winter months, and we would support this.

More broadly there is a strong argument for examining the methodology for the recovery of TNUoS revenue as whole. Currently the methodology does not take into account any spare capacity on the transmission system: the long term costs of the entire transmission system are recovered from short term demand so that, if spare capacity increases, the level of the charge rises and with it the level of embedded benefit. We think there should be a move to include some element of capacity-based charging within the methodology. So, for example, the Triad charges could be based on the maximum demand over a ten year period. A key principle must be that the level of Triad charges must be the same for both demand and generation.

Timing and transitional arrangements

Ofgem has invited views on the timing of any changes and whether there is a need for transitional arrangements. Its initial thinking is that new arrangements arising from a CUSC modification should be in place by 2019-20 and that any grandfathering arrangements could be difficult to justify given the significant costs and distortions that this would likely cause.

FALCK RENEWABLES WIND

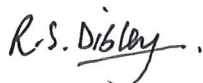
We do not share the regulator's view of the urgency for change for two main reasons. Firstly, the appropriate changes that are needed have not been established in the absence of a full review, which includes establishing the benefits of embedded generation and whether the overall charging methodology needs change. Secondly, imposing too rapid change on the industry will cause market disruption and it will also create a climate of regulatory uncertainty, damaging future investment. In particular it is likely to mean that further changes are subsequently found to be required, in addition to those areas already identified by Ofgem for future work, that create ongoing disjointed change.

A range of Workgroup Alternative CUSC Modifications (WACMs) are now being considered by the CUSC workgroup, and it must decide which of these should be taken forward for consideration by the Authority following the Panel recommendation. The details of all these proposals are not currently publicly available and are subject to change during workgroup discussion. We support the inclusion of a transitional cap, as proposed in the Infinis Energy WACMs, which would enable a period of time to develop an enduring solution. This cap could be sensibly based on an average of recent past year charges.

We note the areas that Ofgem has identified for further work and that it expects to provide further details on this in the autumn. Reference is also made to work being progressed on charging arrangements both at transmission and distribution level. As indicated in our response we believe it's important for co-ordination on these areas so that individual elements such as are not considered in isolation.

We are grateful to have had the opportunity to comment on Ofgem's Open Letter and would be happy to discuss any queries you may have on the contents of this letter.

Yours sincerely,



Richard Dibley
Head of UK Regulatory & Local Affairs