



Energy for
generations

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Dear sir/madam

ESB welcomes the opportunity to respond to Ofgem's open letter on the future of charging arrangements for embedded generation. It is encouraging to see Ofgem engage with industry on this issue and we see this letter as a positive first step in a process that should ultimately lead to a clearer, fairer, future-proofed network charging regime.

Clearly over the coming weeks and months there will be much opportunity for industry to provide detailed views on the future shape of this charging regime so at this stage we simply wish to highlight three areas that we see as being key for Ofgem and industry to address in the short-term. These are as follows:

1. Removing distortions from this year's capacity auction
2. The need for a wider charging review
3. Maintaining investor confidence in GB generation

1. Removing distortions from this year's capacity auction

The first two capacity auctions have brought forward over 3GW of new embedded generation capacity with no other new generation capacity yet to be committed (whilst Trafford CCGT did accept a contract in the 2014 Capacity Auction it has yet to reach Final Investment Decision). Assessing the analysis presented in Ofgem's open letter and the data put forward through the CMP264 and CMP265 working groups it is clear that the ability to avail of triad payments as well as capacity payments is giving small-scale generation an advantage, as evidenced by their success in the first two auctions. Given that triad benefits are set to increase dramatically over the next 5 years without action it is highly likely that the level of embedded generation gaining contracts in the capacity auctions is also likely to increase, at the expense of other forms of generation.

Although we support the principal of a technology neutral capacity auction it is important that technologies are competing on a level playing field and the dominant market position of any technology type should rightly be reviewed. Given the evidence it is apparent that the ability of small scale generation to avail of both triad payments and capacity payments is skewing this playing field in favour of small-scale generation. If this advantage is not urgently addressed there is a danger that there will be a sub-optimal outcome in this year's auction, to the detriment of governments stated objectives of this year's capacity auction (to incentivise new



Gas capacity including large scale transmission connected CCGTs) and with potentially negative impacts on future security of supply.

We understand that the CUSC modifications raised by Scottish Power and EDF seek to deal with this issue and although we have concerns that these 'quick fixes' do not necessarily address the underlying charging issues (see Section 2) and may lead to unintended consequences, the need for a fair and effective capacity auction outweigh these concerns. We would therefore encourage Ofgem to appropriately assess the modifications and their implementation timelines in this light.

2. The need for a wider charging review

As mentioned above, the modifications currently being put through the CUSC process should only be seen as temporary measures to address an immediate issue. We feel that it is imperative to carry out a much wider review of network charging to assess the technical and cost implications of varying forms of demand and generation on the system as a whole. We note that National Grid have started such a piece of work with their wide-ranging review of charging and embedded benefits. We see such a piece of work as a positive step to addressing some of the wider issues facing the current charging regime and we would encourage Ofgem to view this as a strong starting point for expanding into a Significant Code Review (SCR) or similar process.

It is important that any such work not only looks at the current system mix but also incorporates Ofgem's ongoing work in the area of smart energy and storage. It is only by carrying out a full review of the current and future shape of demand and generation on the network that we can ensure that incentives are correct, that the charging regime can adapt to change and that the market is provided with the long-term signals to allow investment in the most efficient mix of technologies.

3. Maintaining investor confidence in GB generation

Whatever the approach adopted by Ofgem and industry in relation to the treatment of embedded benefits we are clearly entering into a period of uncertainty for current and potential investors. It is therefore vital that Ofgem do all they can to minimise this uncertainty and to avoid the unintended consequences of implementing any modifications which would be viewed and treated as retrospective regulation by the investment community.

With this in mind we feel that CMP265 better addresses the issue of investor confidence, as the proposal has a clear time-line and can in no-way be seen as a retrospective change by the investor community. If however CMP264 were to be implemented it would need to clearly define plant which the triad suspension suggested by the modification would apply to. We note this has been discussed at



length in the CMP264 workgroup and forms a series of consultation questions. Although we do not wish to repeat the workgroup's discussion here it is critical that any approach implemented by Ofgem allows for any plant that can demonstrate that it had made a Final Investment Decision (FID) prior to the raising of the modification (17th May 2016) to be exempted from the triad suspension. Plants in this category have committed to significant capital expenditure based on the legitimate expectation that they would be able to avail of such payments. The removal of this revenue stream, on the grounds of what would be viewed as retrospective regulation, would significantly damage business cases for these plants, post their investment decision, and act to undermine confidence in future investment at a time when an investable market is vital to ensuring security of supply and renewable targets are met. Retrospective regulation changes either lead investors to demand a higher risk premium to account for such risks or result in an environment where investors are unable to invest due to the inability to forecast future revenues due to the risk of on ongoing unpredictable interventions. Implementing CMP264 in a way which suspends the benefit for projects that have not reached FID (which will capture the vast majority of new-build embedded generation participating in this year's Capacity Auction) will still have the desired effect of levelling the playing field whilst not unduly penalising plant that has already made investment decisions.

Any longer term solution to the future of embedded benefits would have to carefully consider whether grandfathering of benefits was appropriate. If this was deemed not to be the case, transitional arrangements such as the Delayed change or Split implementation approaches, as suggested in the Ofgem open letter, should be utilised. These approaches should allow investors sufficient timelines to understand the impact on existing and pipeline investments, thereby giving them time to adjust their strategies appropriately.

If you would like to discuss any of the above points in more detail members of the ESB team are available and we look forward to further engagement in this vital piece of work.

Kind regards,

Will Chilvers

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