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23 September 2016

Open Letter: Charging arrangements for embedded generation

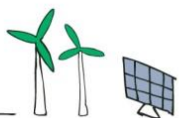
Dear Frances,

SmartestEnergy welcomes the opportunity to respond to your open letter on the charging arrangements for embedded generation dated 29th July 2016.

SmartestEnergy has been an aggregator of embedded generation since 2001 and a supplier in the electricity retail market serving large corporate and group organisations since 2008.

SmartestEnergy is disappointed that Ofgem is currently not minded to conduct a full review of embedded benefits in the context of the whole system. The issues of cost reflectivity and net charging are very complex and wide-ranging and can really only be addressed by a comprehensive review. We are also very concerned that the current timeline for CMP264 and CMP265 is working on the basis that a decision could be made by Ofgem in November 2016. This would suggest that there is not going to be sufficient time for Ofgem to conduct a regulatory impact assessment which considers the wider implications of these proposals on wholesale prices, generators and customers. If Ofgem are to conduct an impact assessment, the CMP264/265 process will have been rushed unnecessarily. As we explain below, we would urge stepping back and taking a different approach by focusing on the individual costs which make up the "residual."

Whilst we would normally be supportive of change being effected through industry-led proposals there are dangers in this instance that uncertainty will persist for many years to come as industry will feel that more change could be round the corner if matters are not settled in a comprehensive review. Ofgem will not be able to consider the arrangements as a whole if proposals come to them in a piecemeal fashion. Indeed, within the P264/265 process so far there has been a dizzyingly high number of WACMs put forward, many of which are narrow and self-interested proposals. This cannot be the most efficient way to proceed.



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We understand that transmission charging is not ideally suited to grandfathering, both from a practical level (separating out volumes of new generation) nor economically. Changes to charging arrangements are clearly the kind of change which have always been a regulatory risk to the development of generation. However, Ofgem are going to have to be very mindful of the impacts on existing generators of removing or significantly reducing the larger embedded benefits as many generators could ultimately become economically unviable. At the very least there will be an impact on the capacity market and the wholesale market as generators attempt to recover their increased costs. For this reason alone Ofgem should be conducting a fuller review of all the major embedded benefits in the round so that the ultimate impact can be understood before any change is made.

The TNUoS charging methodology is meant to result in charges which reflect the costs incurred by transmission licensees. The recipients of these charges are suppliers. Embedded generators are not "Users" as captured in the CUSC requirements to be cost reflective. There is a very solid rationale behind the current "net supplier model"; as far as NGT are concerned there is no difference between a MW of reduced demand or a MW of increased embedded generation. It is therefore not more cost reflective in the CUSC environment to change the charging from net demand to gross demand. In addition to this, under normal circumstances in the majority of GSPs, embedded generation simply does not use the transmission network and should therefore not be exposed to its costs. Indeed, embedded generation offsets the need for use of the transmission system. Also, if it can be argued that embedded generation uses the transmission network, then it can equally be argued that transmission connected generators use the distribution network. Currently, the argument only seems to work one way.

There may well be a differential between the charges seen by transmission connected generators and embedded generators but it is wrong to focus on the value of "embedded benefits." They are a function of the regulatory regime in which the networks are split between transmission and distribution and contractual arrangements in which the supplier is central. The focus should be on ensuring that pricing is cost reflective and appropriately apportioned.

In the debate more recently there has been much focus on the "residual" in NGT's charging methodology. However, if NGT's methodology were more sophisticated (and various price components recovered differently) this would not be an issue. Costs which are currently lumped into the residual should be identified and either allocated to the locational element or charged differently, possibly to distributors. It is wrong to consider changes to the embedded benefit without taking a closer look at the charging methodology itself. It seems crazy to make changes which address effects rather than causes just because NGT's charging methodology is so unsophisticated. Addressing this must be the first step.





What is really at play here is the fact that the residual is increasing because of the €2.50 cap and the aforementioned differential. However, the €2.50 cap is a massive benefit to transmission connected generation in itself and it is this that creates much of the differential.

Given that the greater concern, expressed both by the proposer of P264 and Ofgem, is the projected increase of the residual, coupled with the fact that removing the embedded benefit could destroy the economics of existing plant, it is essential that if there is to be any change made in a way that does not directly reflect the costs which embedded generation causes, it should apply to new plant only. However, we do not agree with this approach on principle for the reasons outlined above.

We would also like to say that we believe that charging embedded generation differently from behind the meter would introduce an artificial distinction that does not currently exist because the net charging of suppliers is consistent with the ownership structure of the networks i.e. the boundary is at the GSP. Indeed, the "behind the meter" problem should give Ofgem cause to consider whether moving to a gross charging basis is the correct thing to do in the first place.

All of this leads us to conclude that, in the absence of a comprehensive review, of all the WACMs on the table under the P264/P265 process, the one put forward by Eider is an example of a sensible way to move forward. This proposal has the following advantages:

- Is non discriminatory
- Is cost reflective i.e. allocates identifiable costs more appropriately
- Does not break the netting principle, giving Ofgem more time to consider the consequences of doing this.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich

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