

Rosper Road
Immingham
North Lincolnshire
DN40 3DZ
Tel: +44(0)1469 556322
Fax: +44(0)1469 556311
www.vpi-i.com

20th September 2016

Open Letter: Charging Arrangements for Embedded Generation

Response from VPI Immingham

VPI Immingham welcome the opportunity to respond to the open letter on charging arrangements for embedded benefits, dated 29th July 2016. VPI Immingham is a combined heat and power (CHP) plant near Immingham, on the south bank of the river Humber. It is one of the largest CHP plants in Europe, capable of generating 1240MW – about 2.5% of UK electricity peak demand and up to 930 tonnes of steam per hour, which is used by nearby Humber and Lindsey oil refineries, representing 25% of the UK's refining capacity.

We welcome the open letter as we believe that the trajectory of the embedded benefit has been unsustainable for some time now, with the burden of costs increasingly placed on domestic consumers. We also recognise and agree with Ofgem's initial assessment that the largest distortion is a result of the demand residual and have concerns regarding the distortionary impact that this has on the wholesale market, whereby embedded generation generates out of merit, dampening price and therefore reducing revenue for those other, predominantly large scale thermal, generators in the market. However, we do not think that action on the demand residual alone will resolve the issue and would suggest that Ofgem undertaken an holistic review.

We also do not believe that other areas, particularly BSUoS, should be ignored. As Ofgem are well aware, BSUoS can be largely volatile so it is not appropriate to use an average cost for comparison. Furthermore, many aspects of BSUoS are not in fact embedded benefits and are for the good of all, e.g. black start costs. The fact that many embedded generators participate in these services yet avoid the charges would seem to be perverse. Embedded generators may also be able to avoid periods of very high BSUoS increasing costs for others in those settlement periods. We look forward to Ofgem's further work in this area and support the approach that any change is well thought through.

We are disappointed by the approach taken by Ofgem regarding amending embedded benefits. This is a highly contentious topic of great importance that will affect every single industry party in some way, whether directly or indirectly. Therefore, we believe that an objective, independently led, holistic project is required that adopts an evidence based approach to change. With so many vested interests, we do not believe that an industry-led CUSC process is the right approach for a change with such a large impact. We would urge Ofgem to reconsider the use of a Significant Code Review (SCR), supported by a detailed impact assessment before deciding on the right framework to take forward.

Furthermore, we believe that there is a very high risk of unintended consequences on the back of the modification process that then spawns multiple associated modifications being raised on the back of CMP264 and CMP265, as has been suggested during the current CUSC process. This will demand huge amounts of industry time and resource and favours those larger organisations with plenty of resource to feed into the process. An SCR, whilst initially more resource intensive and time

Rosper Road
Immingham
North Lincolnshire
DN40 3DZ
Tel: +44(0)1469 556322
Fax: +44(0)1469 556311
www.vpi-i.com

consuming, would avoid the embedded benefits issue rumbling on for many years to come

We also recognise the concerns that Ofgem raise regarding the distortionary impact on the capacity mechanism (CM). Whilst the CM is designed to favour the lowest capital cost projects, the value of embedded generation plus the ability of new build embedded generation to access 15 year contracts under the CM means that it is no longer a level playing field. The fact that new build embedded generation is even able to out compete existing thermal generation is a cause for concern and the reduction in CM clearing prices does not resolve the “missing money” issue that the CM was designed to rectify in the first place. However, we would caution against using a policy tool in one area, in this case transmission charging, to rectify flaws in design of another area, in this case the CM.

In terms of the process of implementation, whilst we support the concept of grandfathering in terms of subsidy, we do not think that this should be extended to charging arrangements. The very nature of charging arrangements is that they are set on an annual basis, finalised at short notice and not fixed for future years and are therefore likely to change substantially from forecast. We would therefore be surprised to find that industry parties had banked projected future revenues at the forecast levels given it has been known within industry for some time that the growth in embedded charges has been unsustainable. There has also been precedent of substantial change regarding charging arrangements, most recently following Project Transmit. For the same reason, we do not support the approach of split implementation. To avoid complexity, the same set of rules and regulations must apply to all parties. However, industry parties do need time to adjust to the change so a time period of 2 to 3 years is appropriate.

Whilst we do not have strong views on the detail contained within the open letter, we do believe that Ofgem should consider the existing approach to Triads and whether this remains fit for purpose given the changing nature of the electricity system. We also believe that locational signals, that are fair, transparent and send the appropriate signals to the market, should remain.

Finally, we would ask Ofgem to work closely with National Grid who have been conducting their own transmission charging review. It is not clear to industry how the two interact, if at all, and we would welcome a joined up approach going forward. What we would not like to see is a short term, ill thought through change that is later further changed as a result of the National Grid review.

We would be happy to discuss any of our comments above in more detail. Please do not hesitate to contact me on the details below should you have further questions.

Mary Teuton
VPI Immingham

Belgrave House, 76 Buckingham Palace Road, London, SW1W 9TQ, UK
T: +44 (0) 20 7312 4469
E: mteuton@vpi-i.com