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Charging arrangements for embedded generation – Ofgem open letter, 29 July 2016

The Scottish Government welcomes Ofgem's decision to assess whether consumer and system-wide benefits can be derived from changes to current charging arrangements for embedded benefits. Ofgem's long-standing concern with this issue is noted, as is the decision to attach priority to Transmission Use of System (TNUoS) demand residual payments.

While we support Ofgem's aim to address rising costs and the associated distortive impacts on the energy system, we have significant reservations regarding the process adopted by Ofgem. We urge Ofgem to reconsider its decision not to address embedded benefits through a Significant Code Review.

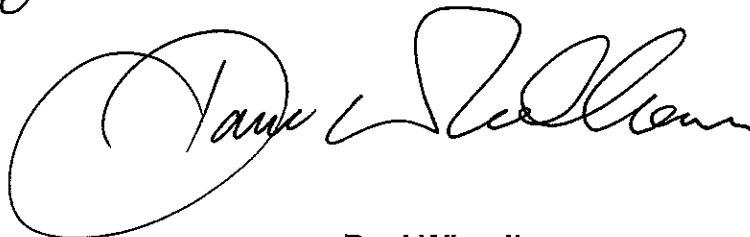
Ofgem's preference for a timely resolution is understandable. However the speed and approach through which a resolution is being sought will have unforeseen, far-reaching consequences. Changes to charging arrangements for embedded generation will reverberate throughout the energy system. This merits the design and implementation of changes that are transparent and understandable. There is a striking level of uncertainty across the electricity sector as to what increasing the cost-reflectivity of TNUoS payments would mean in practice. Adequate time is needed for a robust, impartial assessment of the value of embedded generation on the network and to society as a whole. This impartiality can only come from Ofgem and through a considered, whole-system review of embedded benefits.

The Scottish Government also seeks assurance from Ofgem that at a time of increased recognition of the cost and flexibility benefits of more distributed generation, changes to embedded benefit charging arrangements will not offset progress in this area. In line with the



Ofgem-BEIS Flexibility work programme we, too, view facilitation of greater decentralisation in the GB energy system as playing a vital role in delivering cost-effective supply for customers, facilitating the transition to a low carbon economy and supporting growth and employment in Scotland. It is therefore imperative that due consideration is given to the long-term impact on the electricity system from changes to embedded benefits.

Kind regards

A handwritten signature in black ink, appearing to read 'Paul Wheelhouse', with a large, stylized initial 'P'.

Paul Wheelhouse

Annex A.

Ofgem's approach

The open letter alludes to the far reaching implications that changes to TNUoS payments will have. Proposed fixes will lead to embedded generation being treated differently from Demand-Response and behind-the-meter generation. We note the work Ofgem intends to carry out on a *"range of other matters which may require further work and modification"*, an intention to return and address other elements of embedded benefits, and wider but related changes required for Distribution Use of System charges on account of increased active network management, DNO to DSO transition and storage. Following consultation with a range of industry actors and experts, we are of the view that a holistic, whole-system review of embedded benefits would facilitate greater stability and certainty over the long-run and promote a more enduring solution than the fragmented approach proposed to date.

Impact Assessment

The Scottish Government is of the firm view that at a minimum Ofgem should carry out a robust impact assessment before any changes are made to current arrangements. We note a particular lack of certainty regarding the potential level of system efficiency and consumer benefits to be derived from changes and the revenue and cost implications for a wide array of generation technologies, in particular intermittent renewable generation.

A robust, objective evidence base is required to provide greater confidence that the loss of revenue to embedded generation is justifiable and proportionate to the level of consumer and system efficiency savings to be realised. Moreover, the short- and long-term impact on consumers must be considered in order to encapsulate the potential impact of changes to embedded generation payments on the long-term development of the electricity system.

An impact assessment should work to identify the extent of impacts on the current renewable energy industry in UK, on future investment in low carbon and on the achievement of renewable, community ownership and carbon targets.

Supporting System Flexibility

Ofgem's Flexibility Position Paper recognised the role for distributed generation in providing *"flexibility, creating opportunities to supply locally and provide other services to market actors"* (*'Making the electricity system more flexible and delivering the benefits for consumers'*, September 2015). Additional distributed generation can support the anticipated long-term increased penetration of electrical heating and transport in a cost-effective manner. Local generation can reduce the costs of transporting electricity and consumer bills.

To ensure that progress in meeting future challenges is not undermined by additional financial burdens placed on present and future embedded generation, it is imperative that the system-wide and flexibility benefits that embedded generation can provide are appropriately represented in any system rewarding embedded benefits.

The work-group consultation documents for CMP264 and CMP 265 demonstrate significant disagreement among the CUSC panel members about the size of the benefit and how it is distributed by suppliers to generators. There is considerable range in the calculations for embedded triad benefit, from £32.3/km estimated by Cornwall Energy (*'A Review of Embedded Benefits'*, Association of Decentralised Energy May 2016) and CMP264's

reference to the National Grid estimated value of £1.62/Kw/year. This suggests that there is insufficient clarity to deliver this in the proposed timescale.

If, after such an impact assessment Ofgem was minded to move forward with adjusting the embedded benefits, it will be important to ensure that any increase in revenue due to value being provided in other areas (other than pure Transmission System Utilisation) were timed to ensure that there is not a period where embedded benefits have been removed and flexibility revenues are not available.

Demand Residual

The size of the residual is central to the value of embedded benefit. As part of a reconsideration of charging arrangements for embedded benefits, Ofgem should clearly set out the basis and rationale for the size of the residuals. Greater clarity on the purpose of the residuals, what they cover and how this has a bearing on the actual costs that embedded generators may create or off-set would aid this debate.

Capacity Market

The open letter and CMP 265 highlight that perceived charging defects are specific to the operation of the Capacity Market. The Scottish Government considers that other avenues, constituting a capacity market solution, should be considered further as this may be more appropriate than seeking quick remedies through changes to the transmission charging regime.

If the latter does occur, then as part of an Impact Assessment Ofgem should consider the extent to which changes to TNUoS residual demand will work to deliver changes in Capacity Market outcomes sought by the UK Government, set out in the DECC Capacity Market Reform Consultation March 2016.