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Dear Andrew

**Ofgem's minded to position and IA on CMP264/5**

Corona Energy is a leading independent energy supplier to UK businesses with over 20 years' experience. We currently supply 11% of the Industrial and Commercial gas market, including some embedded generators, with around 11,000 customers. We also supply business customers with electricity, which is a growing part of our business. We therefore welcome the opportunity to respond to Ofgem's consultation.

As an electricity supplier, we fully support Ofgem's proposal to undertake an SCR of network charges. We believe that they could be substantially improved to make charges more predictable and stable, as well as sending clear investment signals to the monopolies. However, we believe that a holistic review is required and in the meantime Ofgem should freeze rather than remove Triad benefits. Any substantial erosion in some parties' income streams, without giving them access to other parts of the market seems likely to undermine investors' confidence and risk security of supply issues.

Please see below our answers to the questions Ofgem pose in their IA. We hope that they answers are clear, but if there are any specific points you wish to raise please do not hesitate to contact us.

Yours sincerely

Emily Wells  
Head of Operations & Regulations



## Corona Energy's Responses to Ofgem CMP264/5 Minded to Questions

**Question 1:** *Do you agree with our problem definition and that the Transmission Network Use of System (TNUoS) Demand Residual (TDR) payments to sub-100MW Embedded Generation ("smaller EG") are distorting dispatch, wholesale price, the capacity market (CM) and that they pose an increased cost to consumers?*

Corona Energy (Corona) agree that the escalation in the TDR is an issue; however, we do not believe that Ofgem has demonstrated that this is resulting in the level of distortions they assert. For example, as a gas supplier to peaking power plants, it is our experience that these plants only despatch at peak times, when power generation margins are tight and power prices high; that would look like they are despatching in merit order. What is Ofgem's evidence that this is not the case?

Ofgem also needs to be careful to refer to merit order when discussing EG plant as a group as a lot of EG is renewable plant and therefore despatching baseload, irrelevant of price due to the nature of the renewables support programmes. Some EG is also linked to industrial processes, for example CHP or WfE plants, which again have economics not driven by the wholesale power price alone. We therefore feel Ofgem needs to actually demonstrate that the distortions they claim are occurring to a degree that create inefficiency and that their solution would alter this behaviour. We are inclined to suspect that impacted plant will either shut, or go on operating exactly as it does today.

Ofgem's analysis may benefit from trying to define different markets for different plant types. For example, EG does not compete in the Balancing Market (BM) so its despatch will not be driven by BM prices. Renewable plant responds to the need to gain subsidies, not to the prices, etc. Ofgem should consider if they have correctly defined the markets. It may be easier to look at a more balanced solution if the impact on different sectors is investigated in a bit more detail.

**Question 2:** *Do you agree that rising TDR payments to smaller EG is a problem which needs to be addressed?*

Yes, but it needs a proportional response. The growth in TDR is a symptom of the increasing investment to support offshore wind farms, expanding renewables in Scotland, etc. These wider policies should really be paid for out of general taxation, as using energy bills is generally regressive. However, the structural changes in the electricity market



suggest that this is a longer term problem which requires a robust solution, which addresses more than just the embedded benefits.

**Question 3:** *Do you agree with our interpretation of the applicable CUSC objectives?*

Yes we agree.

**Question 4:** *Do you agree with our assessment against the applicable CUSC objectives and statutory duties? Please provide evidence for any differing views.*

There is a difficulty in looking at the effects on competition when only looking at the CUSC. For EG to compete with larger generators they also need to be able to access the wholesale energy markets in the way that larger generators can. Ofgem has wider duties and it recognises that it also needs to consider those. However, it does not seem to recognise the wider problems and related distortions that also need to be addressed.

There must also be a concern that those who entered into capacity market agreements in 2014/15 will not be able to adjust their positions until those agreements expire which means investors may simply not build those plants creating a security of supply risks. This seems highly detrimental to competition and likely to create security of supply issues, making it more difficult for the TOs to operate the market efficiently.

Corona are also concerned that the analysis Ofgem has undertaken does not look at the impact of generators on the RO. It is unclear to us how those parties can make up the missing revenues that would have formed a fundamental part of their economic case. While they may not have assumed Triad payments at £45, they probably did model Triad at £20-30, which would have been a reasonable assumption. The competition between different types of renewables does not seem to have been directly addressed.

**Question 5:** *In our assessment against the objectives, do you believe there are any relevant assessments we have not taken into account?*

The issues we do not think Ofgem have considered are:

The impacts on DNO and TO electricity flows and the related impact on monopoly network expenditure. We have seen no analysis about the impact on say DNOs if peaking power stations do not operate at peak periods. We assume that these networks are designed around seeing EG run at peak; can they cope if they do not? To ignore what could be a material impact would seem to be a risky strategy.

Locational charges are noted as being "cost reflective" but there seems to be no analysis to check that this is the case. Were it to be the case, then they are clearly not feeding into the price control investment signals as many of the areas where the market signals the need for new generation seem to be highly constrained, for example in the South West and around



London.

The recent work by Frontier Economics for BEIS<sup>1</sup> seems to suggest that there is a greater benefit from locating plants near demand and suggest that the currently regulatory regime does not correctly value these sorts of benefits. While Ofgem seems to have had some work undertaken by Frontier, the analysis does not seem to have taken account of this work.

The security of supply analysis appears to be quite weak. It seems to assume that all plant with CM agreements will be built. This must be unlikely. There are already plants that have terminated their agreements due to the economics of their plant and it seems inconceivable that so much revenue could be removed and all the investors will still be able to justify their build.

There is also no consideration of the security issues associated with larger plants failing compared to smaller ones. We note that National Grid (NG) has already flagged that a larger nuclear plant (Hinkley C) will need them to hold more reserve as a large plant failing creates a greater security risk. This is not the case with smaller plants, where one can fail with very limited impact on the market as a whole.

Corona question Ofgem's assertions that the investors in EG should have seen this cut in embedded benefits coming. We understand that the 2013/14 review of embedded benefits was the last major review and concluded that nothing should be done. Had Ofgem had serious concerns then it should have raised them in that review, which it does not appear to have done. Ofgem must be extremely careful not to undermine investors by making such material changes in policy with no reasonable notice.

While phasing is to be welcomed, we do not believe that the scale of the change with a relatively short period for implementation will give the impacted generators enough time to adjust their business positions, especially if wider market access is not resolved that the same time.

Finally, and as part of a SCR, we believe Ofgem should consider if there are any impacts on the gas network if the market relies more on larger gas generators in future. In particular, where NG requires gas plant to stay on over summer nights to provide quality services such as voltage support, this may create gas constraint issues. Gas plant may be the answer, but it will need secure gas supplies and with changing energy flows it would be remiss of Ofgem not to at least consider if this could create wider energy market issues.

**Question 6:** *Do you agree with our assessment that, in this instance, grandfathering as set out in the WACMs would be unlikely to best facilitate the CUSC objectives when compared to the other options available to us?*

<sup>1</sup> [Whole power system impacts of electricity generation technologies](#) - March 2017





In general we do not support grandfathering, but in this case we are concerned that without some grandfathering, if Ofgem implements WACM 4, there is a risk to the security of the supply. We are not convinced that the market will, or can, adjust in the way that Ofgem suggested. We also do not believe that the analysis that suggests power prices falling in the longer term can be consistent with the building of new, large merchant gas plant. Ofgem may be right that the capacity market prices could increase to support such investment, but it seems more like that the CM prices will increase but will result in further EG being built, given their economics.

What Ofgem seems to have decided not to consider is a more proportionate response, freezing the embedded benefits while it undertakes a more holistic review of the wider charging regime.

**Question 7:** *Do you agree with our assessment that the value of the avoided GSP investment cost best facilitates the applicable CUSC objectives?*

No. As discussed above, Corona are concerned that the reduction in embedded benefits of this scale represents a real risk to those plants who cannot make up their missing revenues and they will therefore shut, with knock on impacts for security of supply and prices. While Ofgem's phasing looks sensible as a means to tackle such a risk, we feel that the level of income reduction is too great to realistically expect investors to absorb.

Corona are also concerned that Ofgem has not considered all of the benefits of embedded plant. For example, if power stations are connected to the transmission system do the TOs not get a revenue stream that the customers must pay for years to come? However, where EG connect into the DNO's system they pay deep connection charges and therefore pay themselves for the reinforcement. They also avoid the need for investment in pylons, which investment in tunnelling cables, suggest has a high value to consumers.

**Question 8:** *Do you agree with our assessment of the impacts on security of supply? Please provide evidence for provided views.*

As noted previously we are not convinced that investors will, or should, build plants where the economics of their investments have been undermined by a dramatic change in regulatory policy. It therefore seems likely that that some of the plants with 2014/15 capacity market agreements will not be built. Furthermore, it seems likely that some of the plants under the RO will also become uneconomic. The modelling Ofgem has done does not seem to account for these issues, which would appear to have an impact on security of supply, as the electricity network at the current time seems very tight.

**Question 9:** *Please provide evidence to show if there are other cost savings which small*



*EG drive in comparison to larger (over 100MW) EG on the distribution system.*

Corona does not have any specific evidence, but we would assume that EG has a number of benefits that are not fully realised in Ofgem's IA:

- Security of supply, as one EG unit failing is less of an issue than for one large unit and Ofgem's proposed solution will potentially result in plant closures (CM and RO plant);
- Use of existing available DNO capacity, compared to the TO networks which seem congested;
- Less cost to customers as EG pay deep connection charges, green taxes on works power, etc; and
- The visual impact of pylons is far greater than telegraph poles.

It should also be noted that it is difficult to tell what the model assumes by way of running hours, for example in any given day or season. However, in a network with more intermittent power stations, having plants which are capable of starting and stopping quickly would seem likely to have a lower carbon impact. It is not possible to do multiple starts on CCGTs without having implications for operation and maintenance costs; hence they regularly run at low levels during the day rather than switch off and come back on. EG however is designed to do multiple, fast starts but then run for less hours. The overall impact on carbon emissions will depend on the running regimes.

Large CCGTs doing multiple starts may also have impacts on the local gas network, as a fast ramp up can take significant gas creating issues on the gas network particularly if the general gas demand is low. EG does not tend to create such issues as they spread over the country and do not take so much gas. However, unlike CCGTs they are designed to do multiple starts. Were CCGTs to suffer gas constraints than the security of supply issues could be far worse. These related gas supply issues do not seem to have been considered.

**Question 10:** *Is there other evidence that payment above avoided GSP/generation residual would better facilitate the applicable objectives?*

It is not good for competition if the regulator puts business out of business. We therefore believe that less of a drastic cut in Triad payments would represent a better balance between the relevant objectives. An alternative is to use grandfathering or a longer and slower reduction in benefits via phasing. However, the current proposals would appear to risk GB generation businesses with no clear benefit, given the known unknowns around security, despatch economics, etc.

**Question 11:** *Do you believe you have a legitimate expectation or contractual right for the continuation of TDR payments? If so, please provide evidence.*



Yes. As noted above there was a review of embedded benefits in 2013/14, where Ofgem may have raised issues at the meetings (which were by invitation only), but there is no

suggestion in any of the meeting notes that Ofgem had major concerns in this area. Were Ofgem to have believed at the time that there was a major cause for concern then they

should have raised their concerns then, not just in the meetings, but to the market more widely. We note that Ofgem quote some older documents, where concerns were expressed, but investors would have reasonably only looked at the more recent Ofgem decisions, which implied an acceptance of Triads as a concept and the level of benefits not a substantive issue.

Ofgem is right to point out that in a regulated market the parties must expect the market to develop and change. However, if Ofgem is prepared to make such a material reduction in Triad income, without offering the impacted parties a different route to market, they send a signal to all investors that the regulatory regime in the GB energy market is unstable and unpredictable. Ultimately the customers will pay for a higher cost of capacity and the higher returns that investors will want to invest in such markets. While in the retail rather than generation market, it is none the less a difficult convince investors to enter the retail if market if the economics of energy businesses can change so rapidly.

**Question 12:** *Do you agree with our assessment of the distributional issues?*

We are concerned that Ofgem does not seem to have considered the impact on plant who cannot access neither the increasing capacity market payments, nor the increased wholesale prices. In particular Ofgem has not undertaken any robust analysis of the impact on renewables plants under the RO or the older capacity market agreement plants.

**Question 13:** *Are there any sectors that we may have overlooked?*

It is not clear that Ofgem has discussed with the DNOs if the change in electricity flows as a result of the reduced Triads will create system issues for them. We suspect that the DNOs' systems have been designed around the expectation that EG will usually be operating at peak demand periods. What will happen if those plants do not show up, which we believe will be the case as the economics of EG will not work if they cannot access peak power prices and will not get paid Triad payments.

As noted above, Ofgem also do not seem to have analysed the impact on the RO EG who have no obvious means to recoup their missing income.

**Question 14:** *Do you agree with our modelling approach?*

While we welcome Ofgem's modelling, it is very difficult to comment on it in detail given the



information provided. For example, we would have liked to have seen the changes in the despatched plant alter over average daily, weekly and seasonal demand changes.

However, we are concerned that the workgroup and Ofgem's own IA has not analysed some of the wider issues in a robust manner. We support Ofgem having principles, but its regulatory decisions should be based on robust analysis, which considers all impacted

parties. Investors across the energy markets need to know that Ofgem will not put their investments, made in good faith, in danger without due consideration of all the impacts.

We also believe it would have been useful to look at the impacts on the wires networks (DNO and TO). Recent changes in market economics to swing the market to favour EG plants over TO connected plants has had unforeseen consequences. Is Ofgem sure that a move back in the other direction will not have a similar impact? If a lot of EG goes out of business, what is the impact on the DNOs' revenue and do the customers then have to pay substantially higher DNO charges to cover the costs of any stranded assets? Ignoring the impact on DNOs seems very risky.

**Question 15:** *Do you think that our background assumptions and using FES data is an appropriate approximation for status quo?*

Yes.

**Question 16:** *Where WACMs are not modelled directly, do you think our assessment is appropriate (see appendix 8 for detail)?*

It would be useful if Ofgem adjusted its modelling to consider wider issues such as DNO impacts and some plant closures, before then modelling a more balanced response, such as a WACM that freezes the Triad benefit while Ofgem undertakes a more robust, holistic review. There is some ability to extrapolate results from one WACM to another, Ofgem's decision making may be better informed by specifically looking at the results from a more measured, intimate response.

Corona would note that the proposers of CMP264/5 did not request that the Triad benefit was reduced to anywhere near the extent that Ofgem is proposing. This implies that neither believed that the detriment to their competitive position was as great as Ofgem seem to have identified. What has made Ofgem believe that the distortion is far greater than the companies raising the changes seem to believe? Ofgem may find that is going too far the other way and should at least ask why they have found an error that no one else has raised.

**Question 17:** *Of the options available to us, do you agree that WACM4 best facilitates the applicable CUSC objectives?*





No. We believe that the reduction in Triad income undermines the business case for EG. Until wider issues are resolved, such as market access, it would be better for Ofgem to

freeze Triad payments or reduce them by a small amount. Sometimes it is necessary to take a longer time to implement a change and do it properly, than risk a change creating

windfall winners and losers in a manner that will undermine competition and investment.

**Question 18:** *Do you believe that an implementation date of April 2018 best facilitates the applicable CUSC objectives?*

No. For the reasons outlined above, we believe that a smaller, more measured change could be implemented than, but a more robust, longer term solution is required and that will take time to work up.

