

By email: electricitynetworkcharging@ofgem.gov.uk

Dear Sir/Madam

Cornwall response to Ofgem Minded-to Decision and draft Impact Assessment of industry's proposals (CMP264 and CMP265)

This document is our response to the Ofgem minded-to decision on CMP 264 and 265.

We object to Ofgem's minded-to decision and the process for deriving it.

This has been a rushed code change process, one that has all the hall-marks of the regulator setting the agenda to meet government pressure. It has given too little time for all participants to properly engage, despite the huge potential impacts to a swathe of smaller operators and developers and the real risks of "unintended consequences".

Over a year on from its announcement of a review of embedded benefits, it has produced no real or up-to-date analysis of why it believes AGIC is the correct solution. It has disregarded various submissions, including from us, on why a reduction of this magnitude will create other market distortions and real security of supply issues, and has given an explicit steer to the market to expect a worst case outcome ahead of publishing any analysis. This is not an appropriate way to proceed for the arbiter of the eventual decision.

Ofgem has stated previously that it will apply a three-month consultation period for matters that have a wide significance and impact, but its approach here has been contrary to that policy. The deadline has not been extended meaningfully, despite impact assessment corrections being published as late as 15 March.

The overall impression is one of proceeding with undue haste, typified by its extension of the timetable for response following disclosure of basic errors in the report, by eight days; in view of the Easter break this turned out to be an extension of less than four days at a time when many potential respondents would be on holiday. Even at this stage, ahead of the revised response date, Ofgem has on its website that the consultation is "closed" and "awaiting decision". This is not good regulatory practice.

Similarly the proposed rush to a decision by the end of May does not give Ofgem sufficient time to properly assimilate and respond to feedback on such a complex change.

The proposed approach is illogical given the proposed Targeted Charging Review (TCR) and other on-going work on network charges. WCM4 may be introducing new market distortions at a time when Ofgem's own work programme is being ramped up. Ofgem through its various statements and open letters has grudgingly conceded that the decision on CMP264/5 has implications for other elements of network charging, which have a wider policy dimension.

The TCR will inevitably take into account many interactions between the triad demand residual (TDR) and other market arrangements, and will result in a more enduring solution without the value shocks that will flow from this decision. Against this background, we are perplexed as to why Ofgem is insistent it wishes to take the decision on these code changes in isolation.

Above all Ofgem seems unconcerned about investor perceptions of regulatory risk, and how these will be fuelled by the proposed decision. As a minimum, the proposed decision will

result in some plant being inappropriately withdrawn from the market, and there are significant risks that recently committed plant that won contracts the first two T-4 capacity auctions will not proceed. It is unclear from the consultation why Ofgem and its consultants have not addressed this issue in depth and engaged with the market on it. The decision might also delay larger (and longer term) investments in CCGTs at a critical time of significant market change while that risk is better assessed.

Against this background, we think that the change if implemented will be less a patch for the current Capacity Market than a catalyst for a rethink on the GB market's approach to capacity support, which is the very opposite of what officials seem to be trying to achieve.

The difference with its approach in its recent RIIO T1 MPR decision¹, where it decided to do nothing because of the impact on investor confidence, is striking. It is hard to avoid the impression that Ofgem factors in impacts on investor confidence when it wants to justify not to do something, but ignores it (as in this instance) where it wishes to push through change.

A more defensible decision if an urgent decision is required would be to accept a WACM that does not move to a worst-case outcome before the holistic review is complete. Any of the scenario 2 WACMs would be superior, with WACM7 being our preference. It would enable the TCR to take place while also reducing the impact on customers that the increasing TDR could create if no action were taken ahead of the next charging year.

We have received support from a number of impacted parties and two trade associations to critique the Ofgem consultation. It is an independent study that brings into question some of the key assumptions made by Ofgem and its consultants in its impact assessment of these proposals.

This report sets out why over the modelled period additional costs almost eliminate the claimed consumer benefit as:

- The Ofgem impact assessment supporting the minded-to decision on CMP264 and 265 has several material flaws and gaps;
- The benefits of change presented by Ofgem for an immediate and worst case reduction of TDR are greatly overstated. Notably, no account is taken of impact on increased cost of capital and credible impacts on investor confidence;
- Wholesale prices, CM costs and balancing costs will all be materially higher than Ofgem has estimated as several increased costs have been left out; and
- These cost increases arise because WACM4, if implemented, will lead to a higher level of new embedded projects not proceeding, and there being a much less orderly process for new CCGTs filling the capacity gap.

The report is attached.

Yours sincerely,

Nigel Cornwall

¹ https://www.ofgem.gov.uk/system/files/docs/2016/05/mpr_decision_document_final.pdf