

Eider Reserve Power

17 April 2017

Mr Andrew Self
Head of Electricity Network Charging
Office of Gas & Electricity Markets
Energy Systems Team
9 Millbank
London
SW1P 3GE

Dear Mr Self,

Minded to decision and draft Impact Assessment of industry's proposals (CMP264 and CMP265) to change electricity transmission charging arrangements for Embedded Generators

Eider Reserve Power Limited is a holding company for three project companies each of which has a 21MW gross gas reciprocating engine reserve power project. Its sister company Eider Reserve Power Two Limited has two further similar projects – this response to your consultation is being sent on behalf of both holding companies. The projects represent 96MW of capacity which were intended to be built before the minded-to announcement. The future of each of these projects is now in question due to the disproportionate and ill considered position being adopted by Ofgem with which we fundamentally disagree.

Eider is a member of the Flexible Generators Group and that body is replying separately. In that response we make detailed comments on many areas of the proposed changes. Comments in this letter are in addition to comments made therein.

Before turning to the detailed questions which you have posed within your extensive consultation, we wish to restate and re-emphasise a small number of key points:

1. Ofgem has stated that its position stems principally from a fundamental belief that the existing embedded benefits are distorting and incorrect. However there is no detailed evaluation of this core position, i.e. that the value of "X" is as low as one National Grid paper suggested it to be. We consider it self evident that EG avoids the need for transmission infrastructure to be built, either to serve new generation or to replace infrastructure needed for existing TG. That expenditure is at a substantial cost to consumers and makes it clear that X is certainly far higher than suggested. Ofgem has paid scant to no attention to this key point, absent which your position lacks rigor. We consider you to hold a prima facie incorrect position and one which is deeply flawed.
2. Ofgem is appearing to both support and condone a position being taken by parties who will directly benefit from changes which we perceive as a gross distortion of the market in favour of TG to the disadvantage of EG and the detriment of consumers, present and future.
3. The idea that EG is receiving benefits and is therefore able to generate at lower prices than TG, resulting in less TG being built, is suggested as being a distortion. We see it rather as a reflection that EG is a much more economic form of generation as the market moves to requiring flexible generation.

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4. The current system for determining and paying embedded benefits is flawed. That is perhaps the only point on which everyone agrees. Rather than examining it carefully and adopting a better system, as a responsible regulator should do, Ofgem is supporting changes that perpetuate the problem in a different guise.
5. We have neither the time nor resources, as a relatively small company in the sector, to have undertaken a detailed evaluation of the Regulatory Impact Assessment model. However even a superficial review has indicated a plethora of flawed assumptions, some but not all of which are set out in the FGG letter. That Ofgem puts this out on such a key matter without better analysis is deeply concerning.

We are now trying to deal with investor and lending markets in paralysis as a result of this. There is no clarity other than Ofgem's position that nothing can be assumed ever. Investment is about assessment of risk and the statements being made by Ofgem mean that risk is now unlimited. That means the UK electricity sector is close to uninvestable save through large utilities which appear to have the ear of Ofgem. That in turn means that for the consumer, power prices will rise and will do so strongly. That is not in the interests of the UK and is a complete failure by Ofgem to deliver to its principal objectives.

Turning now to your specific questions we reply as follows:

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?

No we do not agree with your problem definition. We note the use of the term "distortions" throughout your definition which implies your view, held without evidence, that payment of benefits is incorrect. You are therefore taking a "guilty until proven innocent" approach but then refusing to look at or consider evidence either way.

Somewhat concealed within your definition is a problem although inadequately brought out. That is the potential, as the volume of EG rises, for embedded benefits to change in a way which may cease to be representative of the inherent value of EG. That is something with which we would agree as a valid concern. However rather than concluding that charging review would be appropriate to consider the issue further, you are seeking to take major and damaging action now on embedded benefits without proper consideration.

You also contend, as part of the perceived problem, that payments are distorting dispatch and wholesale price. We doubt either of these are true as you have characterised them, specifically around Triad periods. Those are by definition periods of high demand and therefore high prices which would cause flexible generators to be running. The Triad structure makes that more profitable but it does not fundamentally drive it. Were it to do however, that could only be to the benefit of the consumers, offsetting any other costs to consumers from the embedded benefit structure.

With respect to the CM then yes, embedded benefits will help drive down CM prices saving consumers money. This goes to the heart of the question – are embedded benefits at the right cost-reflective price and paid in the right way. If they are then this is not a "distortion" and efforts to change it will result in less cost effective generation being built. In our view that will be the result of your ill considered changes – consumers will pay more in the long run for more expensive generation.

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It is certainly true that there is a timing mis-match between the payment of embedded benefits and the receipt of consumer benefits through the non-payment of transmission upgrade/replacement costs. It is the NPV of the savings that needs to be properly considered. As this assessment to date has singularly failed to properly consider the cost benefit of EG, you haven't got off first base with your evaluation.

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

Your question suggests that this is one problem but we consider it to be a combination of different issues which are wrongly and unhelpfully being combined, namely:

- i) the causes of the growth in TDR; and
- ii) the applicability of those causes to EG.

We see the growth in TDR as down to four quite separate and unrelated factors:

- a) growing investment in asset replacement due to the age of many assets on the network and a changing generation mix;
- b) a reduction in generator charges due to the EU cap, compounded by a weak Euro/Sterling exchange rate post Brexit;
- c) the investment required to build new infrastructure for offshore wind;
- d) investment in interconnectors

It is the bundling of all these into TDR which is at the root of the problem in our view. Payments to EG are rising because of these factors, none of which are being addressed by the Ofgem proposals here. Indeed there is no evidence that Ofgem has considered the factors behind the TDR growth adequately in their assessment work.

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

We agree with the statement of the applicable CUSC objectives. We do not agree that the impact of the suggested preferred WACM has been appropriately assessed against these objectives.

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

Facilitating competition

- We do not consider that £1.62/kW is in the least sufficiently robust to adopt as the most appropriate value of 'x' by which to facilitate a level-playing field between distributed- and transmission-connected generation
- There is evident discrimination created between demand side response, behind the meter and other embedded generation which we do not consider to be either proportionate or justified
- The approach taken by Ofgem and the revised value of embedded benefit suggested will have a major negative impact on the growth of storage, an important technology recognised to be very beneficial to intermittent renewable generation. Given our earlier reservations about the value being attributed to embedded benefits, this is adverse to competition
- The narrow approach to only considering embedded benefits without a wider charging review ignores structural advantages which we consider apply to transmission connected plant, skewing the market in their favour and again this undermines fair competition

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Cost-reflectivity

- As above with respect to the value of 'x'
- We do not consider that National Grid's informal review paper did establish, as referenced in this minded-to position, that "the cost of grid supply point infrastructure investment (GSP investment) is the only evidenced cost that embedded generation can help to avoid".
- The minded-to position also notes that through the workgroup process, little evidence was produced to show that a payment above this would be reflective of system savings. The time and resources needed to produce such evidence is beyond the level available to small embedded generators. We do not consider that it therefore follows that the value suggested is the correct value. The process by which this minded-to position has been arrived at has been rushed and we would consider that the manner in which the process has been undertaken has been the cause of relatively little evidence presented

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

Yes we believe there are many assessments and potential effects that have been ignored or inadequately or inappropriately assessed. In particular we consider Ofgem has failed to take account of or explore in any detail the impact on the investor and lender communities and the wider impact that will have on cost of capital for the UK power sector.

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?*

We note that grandfathering is not standard practice for transmission charging and on condition that there is a robust and evidenced approach to finalising the value of 'x' and a more considered approach to phasing, we do not consider that grandfathering would be necessary.

However, as the Ofgem minded-to position stands we consider that grandfathering may be necessary given the extraordinary change that this represents and that existing generation including generation where substantial funds have been spent bringing forward projects cannot respond to the reformed investment signal.

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

We do not agree as set out above. The avoided cost is much more than simply the GSP cost, covering the avoided transmission investment both for the future transmission connected generation required if embedded generation is not to be present at the previously envisaged levels and for asset replacement programmes not needed if TG is to be more extensively replaced by EG.

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

We consider that the impact assessment has not fully assessed the potential impact on security of supply; as shown, for example, in the assumption that all CM-contracted plant will fulfil their contracts as planned and the lack of analysis regarding the impact on the winter supply margin impacts. There is widespread industry belief that many new EG projects will not be built and existing generation may elect to close. As you are well aware

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it is difficult for industry to get high quality information on this area but it does not make the comment any less true.

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.*

It is self evident that EG at every size replaces TG, the latter giving rise to a requirement for transmission infrastructure at a cost to the consumer. We find the argument that the only costs are at a GSP level to not be credible.

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

We consider it obvious that transmission infrastructure is required to connect TG with consumers. The avoidance of this infrastructure investment is the benefit which embedded benefits were intended to reflect. The historic structure of the embedded benefit, reflecting existing investment as a proxy for required future investment, was flawed in our view and probably understated, not overstated, the saving to consumers from EG. For Ofgem to adopt a different position is irrational in our view.

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 we consider we had a legitimate expectation for the continuation of TDR payments at a level broadly comparable with the historic level. Evidence may be brought forward in a future legal challenge should Ofgem take a decision similar to its minded-to position and all rights are reserved in that regard.

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

We reserve on this point as we have a fundamental difference of view in relation to the approach being taken.

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

Rather than sectors being overlooked, we are of the view that the impact on sectors within the industry has been ill considered.

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

No. The modelling is based on many flawed assumptions which even a cursory review has revealed. Some of these are set out in the letter from the Flexible Generators Group of which we are a member. Given more time and resources we suspect we will find much else flawed with the analysis.

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

As above

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

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We consider that all assessments in here are flawed because the wrong approach is being adopted. That in turn invalidates the results of your assessments.

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

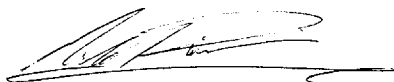
No we do not.

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

No we do not. It represents a rushed and ill considered proposal.

We would like to think that our comments and those of other industry contributors will be fully considered when Ofgem debates further actions. Based on what we have seen to date however we are not hopeful that this will be the case. We therefore reserve our position on any further legal steps that we may take in future.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Michael Davies', with a long horizontal flourish extending to the right.

Michael Davies
Director