

RESPONSE TO OFGEM MINDED TO DECISION AND DRAFT IMPACT ASSESSMENT OF INDUSTRY'S PROPOSALS (CMP264 AND CMP265) TO CHANGE ELECTRICITY TRANSMISSION CHARGING ARRANGEMENTS FOR EMBEDDED GENERATORS, APRIL 2017

EP Invest represents the UK interests of Energetický a Průmyslový Holding ('EPH'), a major energy and utilities group based in the Czech Republic.

EPH owns a large portfolio of energy companies including a major gas shipper from Russia to the EU, the gas industry leader in Slovakia and the electricity supply and heating industry leader in the Czech Republic, as well as generating assets in Germany and Italy as well as Eastern Europe. It has 22.5 GWe of heat and power capacity including coal, lignite and renewables.

In 2015, EPH purchased Eggborough Power Limited, an independent power generator which owns and operates a 2,000 MW coal-fired power station in Yorkshire. This purchase was the Group's initial step into the UK market. In 2016, EPH purchased Lynemouth Power Limited, the owner and operator of a 420 MW coal-fired power station in Northumberland. Lynemouth holds a Contract for Difference for full biomass conversion. EPH is progressing with the biomass conversion project and it is anticipated that this will commission in autumn 2017. EPH is also actively pursuing a number of other acquisition and new build opportunities in the UK electricity market.

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?

Yes, we agree that TDR payments are causing a significant market distortion and are increasing costs to consumers and that this distortion will increase if immediate action is not taken to change the current charging arrangements for distributed generation.

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

Yes, we agree that rising TDR payments are a problem that must be addressed at the earliest opportunity.

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

Yes.

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

In general, we agree with Ofgem's assessment. However, phasing of the implementation of changes to the TDR payment is not compatible with the CUSC objectives of facilitating competition and cost-reflective charging. This is recognised in the consultation document, but Ofgem concludes that phasing is justified due to the 'scale of the changes and the potential impact on security of supply'. As explained in our response to question 8, we do not agree with Ofgem that these issues outweigh the pressing need to address the market distortions arising from TDR payments. We therefore recommend that WACM 3 is implemented.

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

No.

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?

Yes, we agree that in this instance grandfathering would not best facilitate the CUSC objectives and we consider that this assessment should also apply to phasing the implementation of the changes.

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

Yes.

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

We agree that the impacts on security of supply are likely to be small and manageable and that grandfathering of the current TDR payments would harm security of supply. However, we do not agree with Ofgem that a short period of phasing would reduce the immediate security of supply risks and is therefore beneficial.

There is a risk that changes to the TDR payments may affect the viability of new build embedded plant that has received a capacity agreement. However, it appears that less than 4 GW of plant might be affected in this way and, as the TDR payment is only one of many revenue streams factored in to a capacity auction bid, many of these embedded plants may proceed despite the changes to the TDR payment. In fact, over half of this new build embedded capacity accepted a capacity agreement in the 2016 T-4 auction when the direction of travel with regard to TDR payments was already clear. Of the remaining 1.8 GW that accepted agreements in 2014 and 2015, a large proportion is expected already to be under construction. Phasing of the changes to the TDR payment over three years would not influence whether any these embedded plants advance to construction and commissioning as they are 15 to 20 year investments. Furthermore, any shortfall against the 3 hour Loss of Load Expectation created by non-delivery of these plants could easily be made up in the T-1 auctions through to 2020 as the scale is well within the range of capacity available from existing plant which does not hold a capacity agreement.

The greater risk to security of supply identified by Ofgem appears to be that immediate changes to TDR payments would lead to immediate changes to despatch behaviour by existing plant and therefore to greater difficulty in forecasting. However, we consider this risk to be minimal. Our view is that the economics of embedded renewable, Energy from Waste and CHP plants are likely to be largely unaffected by these changes as their business cases rely on other revenue streams. Therefore only existing non-renewable distributed plant could be materially affected. However, the capacity of such plant appears to be comparatively small (data from the Digest of UK Energy Statistics 2016 suggests less than 4 GW) and much of this may be over 100 MW and therefore not eligible to receive embedded benefits. It appears unlikely that this plant was built on the expectation of high TDR payments and these payments would therefore not form a key part of its business model. Furthermore, we consider that these existing plants will remain subject to incentives to generate at peak times from high wholesale prices or will be subject to other forms of incentive through ancillary service contracts. Such plant has also had sufficient warning that changes to the TDR payments are likely and will already have factored this into its future operational plans. We therefore consider that changes to the TDR payment will have a negligible impact on these plants' despatch patterns and this risk does not outweigh the benefits to consumers and the market from immediate implementation of a reduction in the TDR payment.

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.

We do not have any further evidence.

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

No.

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

We are not aware of anything that could have created a legitimate expectation or contractual right for the continuation of the demand residual payment at a particular level.

Question 14: Do you agree with our modelling approach?

Yes.

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)?

Yes.

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

No. As explained above, we consider that WACM 3 (ie. payments to embedded generators reduced to a value equal to the value of avoided GSP investment without any phasing) best facilitates the CUSC objectives and is most consistent with the Authority's statutory duties. Ofgem's analysis suggests that there is a reduction in consumer savings associated with WACM 4 compared to WACM 3 and we do not consider that there are any security of supply or investor confidence benefits from a phased approach which outweigh the reduction in consumer saving.

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

Yes. Due to the serious market distortions caused by the current TDR payments, the change should be implemented at the earliest opportunity.