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Dear Andrew,

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

Drax Group is a UK-based energy company with businesses spanning generation, retail and heat. In recent years we have transformed Drax Power Station into the UK's single largest source of renewable power by upgrading its generation units to use compressed wood pellets in place of coal. Our retail businesses, Haven Power and Opus Energy, are actively engaged in helping businesses with their energy needs, improving efficiency and switching to renewable products. Finally, our renewable heat business, Billington Bioenergy, supplies compressed wood pellets to off-grid homes and businesses that would otherwise continue to use fossil fuels.

We welcome this opportunity to provide comments on Ofgem's minded to decision and draft Impact Analysis (together "the report") regarding industry proposals CMP264 and CMP265. This response is submitted on behalf of the above businesses.

We generally agree with the conclusions highlighted in the report and take this opportunity to raise the following points:

- The WACMs that seek to reduce the Embedded Benefit to the value of avoided Grid Supply Point (GSP) costs best facilitate the Applicable CUSC Objectives;
- The case for grandfathering a subset of generation is not robust and we agree that prudent investors should not have relied on the scale of the current Embedded Benefit when it has been signalled for some time (e.g. under Project TransmiT) that the value would be reviewed and likely reduced;
- We believe changes to the charging regime should allow one full charging year between decision and implementation, which was the principle behind WACM3 – this was the approach used under Project TransmiT and provides a good precedent for charging reform by ensuring network users and consumers receive adequate notice to react to charging regime reform; and
- Whilst we believe greater consumer benefits can be achieved via WACM 3, we appreciate a full charging year's notice can no longer be achieved and, therefore, understand the reasoning behind Ofgem's preference for WACM 4 (three year phasing approach) – we support the conclusion reached.

Detailed answers to the questions raised in the report can be found in Appendix 1. Please feel free to contact me, should you wish to discuss any aspect of this response.

Yours sincerely,

*Submitted by email*

Joseph Underwood  
Industry Code Analyst

## **Appendix 1: Drax Group response to the questions raised in Ofgem's minded to decision and draft Impact Assessment of industry proposals CMP264 and CMP265**

**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 believe that the level of Embedded Benefits is unreflective of the true value of Embedded Generation. An uneconomic feedback loop has created an artificial incentive to connect to the distribution system and not the transmission system. The incentive, which is forecast to increase from its current value of £45/kW to £72/kW, will cause generators to run out of merit and in doing so distorts wholesale prices, the Capacity Market clearing price and investment in generation technologies. Ultimately this will increase the cost to end consumers.

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

Yes. We believe that the rising level of Embedded Benefits is causing inefficient plant to run out of merit in order to receive triad payments while other, more efficient plant are pushed down the merit order thereby dampening the wholesale price. This is likely to be causing distortions in the CM where Embedded Generation in receipt of a large Embedded Benefit will cause an artificially low clearing price, thereby causing uneconomic investment in generation technologies. These unreflective Embedded Benefits are causing an unnecessary additional cost to end consumers.

We believe the defects identified by CMP264/CMP265 are substantial and require a timely resolution to level the playing field. This is best addressed through the CUSC Code Modification process. The use of a Significant Code Review (SCR) is unlikely to bring about a solution in the desired timescales.

**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.**

Yes. We believe that reducing the embedded benefit will create a more cost reflective signal, positively impacting competition. The value of £45/kW is not cost reflective and is due to an inefficient feedback loop – as more Embedded Generation connects, the signal is getting stronger, with the signal forecast to rise to £72/kW in 2021. This also has the effect of promoting less efficient plant to a better position in the merit order.

Ofgem's Principle Objective, to protect the interests of existing and future consumers, will be best met via a more cost reflective charging regime that promotes effective competition. CMP264/CMP265 seeks to set the value of the Embedded Benefit to the avoided GSP investment cost – this better reflects the true impact of Embedded Generation on network investment.

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

No, not at this time.

**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. Given that reform to the value of Embedded Generation versus its impact on network costs has been a known issue for some time (see Project TransmiT), a prudent investor should not have expected the value of Embedded Benefits to reach the current level when making its investment decision. To apply grandfathering to the charging arrangements in relation to Embedded Benefits will create moral hazard, rewarding inefficient investment decisions and entrenching ineffective competition. It is also discriminatory, given this has not been the model favoured for charging related changes with similar distributional impacts since the inception of the 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?**

Yes. There is strong evidence that generators impose similar costs on the transmission system regardless of whether generation is connected to the transmission or distribution network, except for the costs associated with the avoided reinforcement on GSPs. Therefore options that seek to set the value of the Embedded Benefit to the avoided GSP investment cost will reflect the savings of reinforcing the points where the distribution system meets the transmission system.

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

Yes. We believe that security of supply is unlikely to be affected, particularly with the CM T-1 safety net. Further, we agree that a three-year phasing to new arrangements will allow for a stable transition and minimise security of supply concerns. Our original preference was for WACM 3, which was based on the principle of allowing one full charging year between decision and implementation. However, we recognise that there will no longer be a full charging year between decision and 1 April 2018, therefore an alternative proposal that delivers a proportional implementation approach, as provided by WACM 4, may be more appropriate.

**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.**

At this time we believe Ofgem and Frontier Economics have addressed the major aspects of Embedded Generation cost savings.

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

There is strong evidence showing that the impact on transmission costs is the same regardless of whether plant is connected to the transmission or distribution network, except for the costs associated with the avoided reinforcement on GSPs. We do not believe there has been any robust evidence to include additional payments, such as the generation residual, in Embedded Benefit payments.

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

Prudent investors know that charging arrangements are subject to change through the code governance process – the main point of contention is whether reform is adequately signalled to allow investors to change business plans in an orderly fashion. Whilst charging reform that has not been adequately signalled may give rise to the consideration of further transitional arrangements, this particular issue has been signalled for some time, as evidenced under Project TransmIT.

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

Yes.

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

No.

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

Yes. We believe Frontier Economics have considered a wide range of scenarios and have used robust assumptions.

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

The FES scenarios are widely used throughout industry analysis and are used by BEIS for forecasting and decision making purposes. Therefore, without a better data set being available, these are appropriate assumptions.

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

The options modelled represent the viable variants presented by the CMP264/265 Workgroup. The approach is broadly appropriate and we note that the analysis is based on robust assumptions.

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

As demonstrated in the CMP264/CMP265 final workgroup report, there is no difference in costs imposed by transmission and distribution connected generation, other than the reinforcement costs at GSPs. We therefore agree those WACMs that reduce the Embedded Benefit to the value of avoided GSP costs best facilitate the Applicable CUSC Objectives. These WACMs seek to deliver a level playing field, increasing competition between transmission and distribution connected generation and delivering a cost benefit to consumers.

We believe changes to the charging regime should allow at least one full charging year between decision and implementation, which was the principle behind WACM 3. This was the approach used under Project TransmiT and provides a good precedent for charging reform by ensuring network users and consumers receive adequate notice to react to changes made to the charging regime.

Whilst we believe greater consumer benefits can be achieved via WACM 3 (earlier implementation), we understand the reasoning behind Ofgem's preference for WACM 4 (three year phasing approach) and support the conclusion reached (see answer to question 8).

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

Yes, provided there is a timely decision by Ofgem following the submission deadline of this consultation.