

14 April 2017
Mr Andrew Self
Energy Systems
Ofgem
9 Millbank
London
SW1P 3GE

Dear Sir

Embedded benefits: Consultation on CMP 264 and CMP 265 minded to decision and draft Impact Assessment
Falck Renewables Wind Ltd is the UK subsidiary of Falck Renewables SpA, a publicly listed company based in Milan (hereafter referred to as “Falck”). The company has two UK offices, in London and Inverness, and employs approximately 32 staff in the UK. Falck has interests in onshore wind, waste to energy and solar, although to date in the UK the company has been involved exclusively in onshore wind developments.

Falck operates a portfolio of 822 MW of renewable energy installed capacity across a number of European countries, including Italy, Spain, France and the UK. The UK portfolio comprises 12 operational wind farms. These represent an installed capacity of approximately 450 MW. Ten of these projects are located in Scotland, one in Wales and one in England. Falck also has planning consent for two further projects in Scotland. All of Falck’s projects are embedded in the local distribution network with the exception of two transmission connected projects in the Highlands. Falck receive a share of TNUoS Demand Residual (TDR) payments for the 320MW of our embedded UK wind projects. Although the output of wind farms is unpredictable across the 3 half hour Triad periods the value of the TDR payments averaged across our fleet over the years is an important contribution to our project revenues and the proposal to reduce TDR to £1.62/kW will have a significant impact. Most of the projects are in Scotland and we are concerned about the additional impact when the locational element is added.

As we have indicated in our previous response to Ofgem we support the intervention to manage rising TDR payments but we do not support the proposal to tackle this issue in isolation through a CUSC modification. Embedded generation makes an increasingly important contribution to the electricity network and a piecemeal approach that addresses only one part of the arrangements is likely to have a number of serious detrimental or unintended consequences. Our proposal was that TDR payments should be reduced to a lower level for a period of 2 or 3 years while a wider review of embedded benefits and charging takes place. WACM9 was one of the Work Group proposals which was structured in this way with the TDR payment to be set at £34.11/kW for the first year and £20.12/kW for the second year pending the outcome of a wider review.

We do not feel it is appropriate to rush through changes in embedded benefits to address perceived problems in the outcome of the Capacity Market, particularly as over 20GW of existing embedded benefits, which

operate outside the Capacity Market, will be impacted. We have covered this point below in response to Question 6.

We note that since this consultation was published Ofgem have published a consultation on a Targeted Charging Review to look further at embedded benefits and the current charging arrangements for EG. As discussed above and in our previous response we have suggested that TDR payments should be considered as part of a wider review and we would welcome TDR payments being considered as part of this wider review, with a temporary measure put in place to address escalating TDR payments, rather than the proposed decision to cut TDR to £1.62/kW without the wider review.

We would also support a review of how the payment of the TNUoS demand residual charge is based on generation during three half hour (triad) settlement periods, as the current mechanism does not incentivise efficient operation of some embedded plant. We understand that proposals have been made at the CUSC panel sessions (CMP 271 & CMP 274) to base triad payments on a broader period of generation over the 4 winter months and we would support this.

Our responses to the Questions raised in your consultation are 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?

We agree that TDR payments are escalating as a result of the way they are calculated, but we don’t agree that TDR payments increase costs to consumers through distorting dispatch, the wholesale price and the Capacity Market. Your report identifies that EG are causing reductions in peak power pricing and capacity market values which is reducing costs to consumers. Additionally EG are typically not involved in the balancing market so they do not directly affect dispatch. The biggest influence on capacity market auction prices are the large centrally despatched generating plant whose capital costs have already been written down. We note that resolving the perceived problem that larger CCGTs and OCGTs are not competing on a level playing field with smaller EG because of TDR payments, could alternatively be resolved by changes to the Capacity Market. Such an approach would avoid impacting 20 GW of embedded plants built over the last 2 decades, which does not participate in the Capacity Market.

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

Yes we agree that there is a problem with the methodology used in the calculation of TDR payments which have escalated over recent years. We agree that a correction is necessary, but our concern is that the analysis carried out is insufficient and too narrow. We would welcome this issue being considered as part of a wider review.

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

Like other Parties who responded to Ofgem's initial letter in July 2016 we supported the view that TDR payments should be reviewed as part of a wider review of charging with TDR payments being frozen or reduced to an interim level while that review is completed. The concern is that the effect of just tackling TDR payments is that the outcome is not fully thought through. For this reason we would question whether the first CUSC objective of facilitating effective competition will be met. In our response to Question 7 we have highlighted that the charging and balancing market participation are different for transmission connected generators versus EGs and the concern is that the proposed change in TDR payments will not facilitate effective competition because of the significant negative impact on EGs.

We were not directly involved in the CUSC Mod Working Group discussions but reports we've heard indicate that the process was dominated by the large Utilities whose interests are aligned with large transmission connected generators rather than EG. These parties have a vested interest in tipping the playing field in favour of large transmission connected generators to the detriment of EG. It's not apparent that the proposed new value of TDR of £1.62/kW has been subject to a full up to date analysis of the benefits to the Network of EG.

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

As stated in the response to Question 4 a more wide ranging review of charges would facilitate a more reliable assessment of whether CUSC objectives will be achieved.

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 do not agree with your conclusions about grandfathering. Our view is that grandfathering is an important principle which helps protect investor confidence, and it should be observed wherever possible. As stated in our response to Q2 we agree that the TDR calculation methodology needs to be reformed because it's value is escalating to excessive levels, but billions of pounds have been invested over many years in over 20GW of embedded generation in the expectation that those projects would receive TDR payments (in excess of £1.62/kW). We would support grandfathering for existing EG at a reduced TDR value in the range £20-£30/kW as we acknowledge that TDR payments have got too high and should be reformed.

We note the comment on page 6 of your report that "prudent investors know that charging arrangements are subject to change through the code governance process". We would take issue with this comment as to our knowledge the "Triad" payment has been in existence since Electricity privatization in 1991 and all embedded generation plant built since that time would have been built with the expectation of receiving a share of Triad benefits as part of their forecast revenues, on which their investment case would have been based. We accept that TDR has been under review over the last few years because of the escalation of TDR values and because of perceived problems with the outcome of the CM but we do not agree that the majority of investors in embedded generation should have expected this change, particularly such a severe reduction (94%).

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

We think there are factors that need to be considered aside from the avoided GSP investment cost. The different connections policy between transmission and distribution potentially favours transmission over embedded generation because transmission generation connects under a shallower connection policy and therefore pays lower initial charges. However, this leads to higher TNUoS which feeds into the Triad charging regime. So if the Triad benefit were to be substantially altered without aligning the transmission and distribution connection charging regimes this could provide transmission-connected generation with a cost advantage.

The potential for the generation residual element of TNUoS to become negative as a result of the cap on generator charges imposed by European legislation and the recovery of local costs for onshore windfarms is a concerning development as it would not be cost reflective and would provide transmission-connected generation with a cost advantage.

Transmission connected generators tend to have full access to the wholesale market and Balancing Mechanism that enables them to achieve an additional revenue stream that is not open to the majority of embedded generator. The impact is to potentially lower its marginal cost and confer an advantage when bidding into the Capacity Market and CfD auctions.

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

Our view is that the dramatic reduction in TDR will inevitably impact security of supply and will impact important initiatives around the growth of storage and Demand Side Response (DSR). Some older embedded plant and particularly peaking plants which rely on TDR payments as part of their revenue stream may be mothballed or closed because of this change. Many projects that have been successful in recent capacity markets auctions may now not get built. There is clearly no guarantee about the auction price of replacement new larger generating plant and Frontier's analysis forecasts that there will be an increased cost to customers through rising CM auction prices.

Recent years have seen major initiatives to help the growth of storage and DSR on our network. These initiatives will help make the network more flexible, better able to respond to changing patterns of demand and the loss of large coal plant which have historically provided many ancillary services. TDR payments would have provided an important contribution to the investment case revenues for these storage and DSR projects.

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.

Our previous response to Ofgem referenced the work carried out by Cornwall Energy which analysed the avoided costs created by EG. This analysis showed a substantially higher contribution than the figure of £1.62/kW. Cornwall Energy's analysis is more recent than the analysis which resulted in the valuation of £1.62/kW.

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

As indicated in the response to Question 6 we believe that there is a legitimate expectation that TDR payments would continue, rather than being reduced close to zero, based on EG receiving these benefits since Electricity Privatization in 1991.

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

Your analysis of potential change included for 3 different generation patterns on page 58 of your report, includes a typical intermittent wind generator as generator B. The analysis assumes a 30% annual load factor and output at peak of 5%. Output at peak of an intermittent wind generator is likely to be closer to the average load factor (ie 30%). This is relevant as the use of a very low peak load factor downplays the likely impact of the reduction of TDR on wind projects, and is not representative of the likely more significant impact.

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

It seems that the main sectors are covered.

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

We agree that TDR payments to EG need to be reviewed but we would suggest that a smaller reduction than per WACM4 would be more appropriate. We anticipate that the proposed drastic reduction in TDR will have consequences outlined in response to Q8. These consequences will include reductions in security of supply and increases in Capacity Market prices.

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

Our preference is that the proposed reduction in TDR should be implemented over as long a period of time as possible. We support the proposal to phase the reduction over 3 years and would support a longer period if possible to minimize the annual impact on existing embedded generators and to allow time for them to adjust to the economic impact. In our response to Ofgem's original Open Letter of July 2016 we stated a preference for TDR values to be frozen for a period of around 3 years while a holistic review of charging is carried out so that a subsequent change in TDR could be introduced after reviewing the whole picture rather than a piece of the picture.

Once again we thank you for the opportunity to participate in this consultation and we would welcome the opportunity for further dialogue.

Yours sincerely



Sergio Chiericoni

Managing Director

Falck Renewables Wind Limited