



Reliance Energy Limited

Unit 2 Rectory Court

Old Rectory Lane

Birmingham

B48 7SX

Reliance Energy Response:

Ofgem minded to decision on CMP264 and 265

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Neil Drake, Director
Reliance Energy Limited
neil@relianceenergy.eu
07422677242

Introduction

Reliance Energy Limited (REL) is an EIS funded professional services company that provides the expertise and management in the development of flexible standby power facilities in the UK. In doing so, our clients provide reliable, responsive short-term electricity when national demand is at its peak or during periods of network instability and shortage. As an operator and developer of small, flexible generation plants, REL's clients provide a valuable contribution to ensuring security of supply in an energy market that is changing rapidly.

REL has a number of clients including AIM listed plc, Bond funded plc. and privately funded limited companies. As such we regularly interact with potential funders (debt and equity) in energy generation facilities. This leaves us well placed to comment on the impact of this consultation on both planning flexible generation capacity and on the crucial issue of investor sentiment.

We have directly supported Cornwall Energy's assessment of the Ofgem minded to decision on CMP264 and 265 and would refer Ofgem to this report for a more complete articulation of our perspective.

We would summarise our views as follows:

- The benefits of change presented by Ofgem for an immediate and worst case reduction of the TNUoS demand residual (TDR) charge are greatly overstated
- No account is taken by Ofgem of the impact on increased cost of capital for generation developers. In fact, we have already seen this more expensive funding negatively impacting the commercial viability of previously credible projects. These projects would likely have been bidding into future Capacity Mechanism auctions at prices lower than historical clearing prices
- Several increased costs arising from implementation have been omitted from the assessment or are understated. These cost increases arise in our assessment because:
 - embedded generators that remain on the system will seek to replace lost revenues in other markets
 - a higher level of new embedded projects will not proceed adversely impacting on security of supply reducing the assessed benefits, and

- there will under any scenario be a much less orderly process than that assumed for new CCGTs filling the capacity gap
- As a result wholesale prices, capacity market (CM) costs and balancing costs will all be materially higher than Ofgem has estimated
- Overall over the modelled period these factors materially reduce the assessed consumer benefit. There are in addition a number of risks of unintended consequences that Ofgem does not take into account that lead us to conclude that the proposal to implement WACM4 is unsound.
- In terms of process:
 - This is a rushed code change process that has given little time for participants to fully engage. Ofgem has stated that it will apply a three month consultation period for matters that have a wide significance and impact. Ofgem's approach is contradictory to their policy. The deadline has not been extended meaningfully despite impact assessment corrections being published on 15 March.
 - There has been insufficient time for effective analysis by smaller generators without the benefit of large regulatory teams.
 - Decisions on enduring rule changes should only be made after conclusion of various other network charging reviews that are already underway, including the recently announced Targeted Charging Review (TCR). It is likely that the TCR could result in competing or conflicting changes involving (i) different charges for firm/non-firm connection; (ii) capacity v energy charges; (iv) recovery of fixed/sunk costs; (iii) greater locational differentials; and local balancing charges replacing transmission charges over time recognising the contribution embedded generation makes to security of supply.
 - Ofgem has also published international analysis as part of its proposals to conduct the TCR, but only after the consultation on the minded to decision was underway. This shows unambiguously that the difficulty of addressing distortions in fixed/sunk cost recovery in a fair and proportionate way, and demonstrates the need for a managed transition over several years.

In conclusion, we would add that as a result of these failures in process and the apparent ineffectiveness of the interventions proposed, we have observed significant degradation in investors' and funders' faith in Ofgem as a credible Market regulator. This is in no one's interest – least of all the UK consumer. Without a credible regulator providing appropriate control and regulatory stability, smaller generators and suppliers have to work with funders with high risk appetites and high return aspirations. Ofgem should be in no doubt that while this consultation is in a relatively small area of the energy market, investors are watching to determine what premia they include in their calculations for regulatory risk. This can only reduce competition and raise costs for the UK consumer, the very antithesis of Ofgem's role. We strongly encourage Ofgem to review their thinking - not on this issue, but in their wider approach to regulatory intervention.

Neil Drake,
Director, Reliance Energy Limited