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

Dear Andrew,

SmartestEnergy welcomes the opportunity to respond to Ofgem's minded-to decision and draft Impact Assessment of industry's proposals (CMP264 and CMP265) to change electricity transmission charging arrangements for Embedded Generators.

SmartestEnergy is an aggregator of embedded generation in the wholesale market, an aggregator of demand and frequency services and a supplier in the electricity retail market serving large corporate and group organisations.

Please note that our response is not confidential.

Overview

We have serious reservations about Ofgem approving any modifications in this area at the moment. CMP264 and CMP265 were raised as stop gap modifications in the expectation that Ofgem would conduct a proper Significant Code Review (SCR). For this reason the proposed modifications did not consider the periods over which TNUoS is charged (or more accurate cost reflectivity) and proposed a simple change to the netting arrangements. This would have been a more justified approach if the SCR had taken place. However, having signposted an SCR Ofgem have backed off and there is no guarantee that anything more sensible will be implemented at a later date.



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In our opinion relying on adjustments to the netting arrangements leads to unintended consequences; it is simply moving the netting boundary from GSP to meter without addressing (with firm proposals) the greater unfairness in comparison with “behind the meter” generation which would be created as a result.

We believe that CMP271, CMP274 and CMP276 are all significantly superior modifications to CMP 264 and CMP265 because they address how TNUoS is charged and Ofgem should wait for these to be developed. Further cost reflectivity should be the subject of an SCR.

Before change is instigated a greater understanding is required of the exact nature of the locational and residual elements, the latter being in reality a ragbag of costs which NGT are unable to allocate accurately because their charging is not sophisticated enough. The residual would not be so high, for instance, if the costs associated with exporting GSPs and offshore interconnectors were allocated properly. The Frontier Economics analysis also simply takes the nature of the residual as read and their analysis is therefore fundamentally flawed. The remaining locational incentive is not strong and we believe this could cause issues in the future.

We answer the questions below in the order in which they appear in the consultation document.

**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. The document states the following: “Historically, total transmission charges were lower than they are today and the amount of smaller EG was small meaning that the distortions caused by the payments were also relatively low.” It is incorrect to characterise this feature as a distortion at lower levels. There was a perfectly logical rationale for the payment historically viz that embedded generation offset the use of the transmission network. To suggest otherwise is an attempt to rewrite history. It is also hardly the fault of established embedded generation that more has recently been built leading to the “distortion.” The proposal to move to gross charging is, in our opinion, a change so fundamental (because the concept of negative demand is not part of the new thinking) that a review is required to ensure that the new “world view” is internally consistent.

Ofgem should also be addressing the wider issue relating to the need for system-wide charging. Ofgem state that they “recognise that there is a tension between the need to deal quickly with the most immediate distortions and the need to ensure the



network charging arrangements work as a consistent, coherent whole." However, there are still no plans to progress this on their part.

In the document Ofgem are at pains to put the value of the embedded benefit in the context of the latest Capacity Market (CM) clearing price. But at the same time £2/kW is patently far too low.

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

Yes. But it needs to be done by addressing the periods over which TNUoS is charged and allocating costs within the "residual" more appropriately. A genuinely cost reflective approach would combine peak and usage charging. The problem also needs to be addressed in conjunction with Distribution charging (something which the Frontier Economics analysis failed to include) such that a proxy for whole system charging can be introduced.

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

Clearly, competition and cost-reflectivity are the most applicable CUSC objectives to assess the proposals against.

We agree with the comment in the document that "Competition is best facilitated by non-discriminatory arrangements that do not inherently favour particular market participants." What needs to be appreciated is that a small generator cannot be compared to a large one at the extremes. How can it be expected that a customer with a generator behind the meter should have to pay for transmission capacity on a gross basis? Indeed, this generator might not even be known about. In our view it is fairer for small generation to be treated the same regardless of whether it is just behind or just in front of the meter and for larger generation which is on the Transmission network to be treated differently.

The very fact that the new proposals are going to have to "floor to zero" tells us that the solution is not inherently perfect/cost reflective. Flooring to zero by definition makes it less cost reflective. The locational signals already appear to be weak and the current proposals make them even weaker.

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



Please see answer to Question 3

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

Please see answers to other questions in this document.

**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 understand the economic arguments in terms of treating all embedded generation equally. However, the context of the changing view of "negative demand" should be taken into consideration and, as we point out above, it is hardly the fault of established embedded generation that more has recently been built leading to the "distortion." It is also a massive change; to accept that £45/kW is appropriate one year but that £2/kW is appropriate three years later is simply not credible. As a compromise for those looking for grandfathering why not phase in over a longer period? In reality, the phase period currently proposed is two years, not three.

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

No. This approach stems from the belief that the residual is a "thing." In large part it is a function of other costs not being charged appropriately elsewhere.

The document states the following: "Our provisional view is that the current payments made to smaller EG by suppliers for offsetting their transmission system demand are not cost reflective, as the payments do not reflect the level of savings that smaller EG confer on the transmission system." We believe that that is precisely what the payments were designed to do; they do reflect the level of savings that smaller EG confer on the transmission system because of the offsetting. That is not to say that there is no issue with Triad payments now that we have a capacity market. However, Ofgem need to take a more holistic view of all charging and treat it as if it were one system by ensuring that the benefits of local generation and the varying degrees of reliance on the transmission network are fully reflected.



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

Phased implementation should at least help to mitigate any unforeseen impacts on security of supply by the proposed change. The issue is really one of cost. We are not certain that the implications for increased network investment compared with the counterfactual have been given sufficient consideration in Ofgem's assessment. We understand that if the proposals were to lead to issues with security of supply, the Capacity Market should be capable of making up any shortfall. However, to rely on this more analysis is probably needed on both timing and costs.

**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.

The cost saving is the offsetting of demand which small embedded generation achieves.

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

Please see answers to other questions in this document.

**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 believe that there is a legitimate expectation for the continuation of TDR payments. This is for the reasons we set out in our answer to Q6.

It is true that "any investor in smaller EG can reasonably expect that the level of TNUoS charges it is required to pay (or the level of payment it receives) are subject to regulatory change." But such an investor would not reasonably expect such fundamental change to come without some accompanying structural change whereby a change in perspective could be expected. Here the decision to ignore the concept of "negative demand" appears to be random and unjustified.

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



The document states that Ofgem do not expect the revenue impact on distribution-connected sub-100MW Combined Heat and Power (CHP) operators and Energy from Waste (EfW) plants to be particularly significant. We do not agree with this. We are aware of many 50MW CHP and CCGT sites who collectively provide a sizeable chunk of capacity to the system through Triad seeking and who do not have significant other sources of revenue as implied by Frontier Economics.

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

The document states that Ofgem recognise that a reduction in payments to smaller EG may increase the incentive to move generation behind-the-meter (BTM) to net off consumption and reduce charges and that Ofgem are proposing to consider this issue as a priority area for the TCR. It is not appropriate to deal with the two issues in isolation because there is no guarantee of a satisfactory resolution to the BTM issue and Ofgem could be left with an unresolved discriminatory situation which is more obvious than the one they are trying to address with their proposed approval of this modification.

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

No comment.

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

No comment

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

No comment

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

WACM 4 does at least contain the sensible element of phasing. However, for reasons given elsewhere in this response, we cannot believe that the value of embedded





generation is so low as £2/kW. Unfortunately, there are no options available to Ofgem which include phasing and a more realistic number. We believe, therefore, Ofgem should reject CMP264 and CMP265 and wait to approve one of the modifications which are going to look in more detail at the way in which TNUoS is charged, namely CMP271, CMP274 and CMP276. Ideally, an SCR would look at the nature of the residual in more detail and allocate the costs in a more sophisticated manner.

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

No. For changes of this nature it is customary to give two years' notice because of the prevalence of two year fixed contracts in the market.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich

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