



Embedded Benefits: Consultation on CMP264 and CMP265 minded to decision and draft Impact Assessment

Ofgem March 2017

Stag Energy Response

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

STAG ENERGY

Stag Energy is a British company focused on the development of energy infrastructure assets in support of secure, affordable energy supplies while meeting the Government's low carbon objectives. The company draws on a depth of experience in the energy sector. The Stag Energy management team has been involved in the creation and delivery of over 10,000 MW of power generation and related infrastructure projects worldwide and raising over £6bn of private sector financing.

In the UK power sector, Stag Energy is currently leading the development of new generation facilities designed to provide low cost, reliable capacity to support system security of supply. Stag Energy has supported Watt Power Limited ("Watt"), a new market entrant in the last decade, to develop one 6 MW project which is currently in operation and a further 140MW, all of which secured Capacity Agreements in the electricity capacity market auction 2015. These projects are scheduled to start construction with 60 MW expected to be operational by Q4 2017 and the remaining 80 MW to follow in Q4 2018.

Stag Energy was responsible for the successful development of four 299MW transmission connected gas-fired generation projects, which continue to utilise the ongoing support and project management services of Stag Energy.

Stag Energy recognizes the need to balance commercial considerations with environmental issues when developing energy projects and is confident that this can be responsibly delivered at a local level.

COMMENTS ON OFGEM'S MINDED-TO-DECISION ON CMP264/5

Stag Energy are very concerned about the Minded-to-Decision published by Ofgem.

The proposal to reduce the TDR payment from approx. £45/kW to £1.62/kW, represents a large scale cut in revenue which will have a negative impact on both conventional and renewable generators connected at the distribution network level. This will reduce the margin of flexible capacity on the system, threaten security of supply and increase the risk of higher electricity prices especially for residential and SME customers at times of system stress.

Stag Energy appreciates the need to curtail the exponential rise in TDR payments and devise an appropriate cost recovery mechanism for the current system. However, the magnitude and pace of the changes proposed by Ofgem will risk delivery of projects already contracted under the Capacity Market. As discussed below, the proposed changes have implications for debt providers and impose an "unreasonable" level of risk on equity providers. Therefore, Ofgem's proposals are likely to cause the failure of embedded generation projects that find a long-established revenue stream suddenly slashed and therefore unfinanceable or uneconomic to build.

Stag Energy is not confident that Ofgem has properly addressed the risks to both security of supply and short term price volatility resulting from these potential failures in the Minded-to-Decision Impact Assessment.

Stag Energy believes that the Ofgem Minded-to-Decision promotes a short-term interventionist solution that will have unintended consequences. The change from the current triad price structure, to the Ofgem minded-to position reduces investment returns by approximately 10% to a level where

it will be questionable whether new projects can secure construction funding and existing projects will be at risk of defaulting. We can only conclude, therefore, that ~4.2 GW of embedded generation¹ is vulnerable and at risk of failure. As we have seen from the failure of Trafford – proposed plant will be forced to terminate contracts if they become unfinanceable.

Rather than implement the current minded-to position, an approach in keeping with Ofgem's responsibilities would be to cap TDR payments at current levels, to allow Ofgem the time to undertake a holistic review of system charging arrangements (by way of a SCR), after which longer term solutions can be proposed and implemented with the support and understanding of the whole generation sector. WACMs 7, 8, 9 or 10 could all be implemented to either freeze TDR payments or cap TDR payments at lower levels while Ofgem undertakes a SCR.

If it is decided finally to cut TDR payments as proposed, then, Stag Energy suggest that any change be introduced at a pace which business can accommodate.

We believe that it is a legitimate expectation of both plant owners and the financial community to expect the continuation of TDR payments. It should be noted that the current structure for the allocation of transmission system costs has been in place since before privatisation and was left unchanged following a detailed review by National Grid in 2013/14. Furthermore, lenders have become sufficiently comfortable with the longevity of the structure, and the fact that it was recently subject to a detailed review from National Grid, to commit debt against such Triad income over 7/8 years. This is based on the National Grid five year forecast with post 5 year revenue held flat, which was viewed as conservative. While the outrun TNUoS values are acknowledged as different from the forecast, the methodology NG use for calculating is published, allowing lenders to take a well-educated long term view. Therefore, the cut to TDR payments should certainly not be understood as simply an equity issue, but also a debt issue.

Projects taking CM contracts in the 2014 and 2015 auctions had visibility of TNUoS forecasts from National Grid in Jan 2015, then Jan 2016 through to the winter of 2021/2022 to support debt financing. A radical change to the embedded benefits structure in advance of that date, as proposed by Ofgem, will undermine financing that has been put in place for 2014 and 2015 embedded CM projects. To support these embedded generation projects through the transition to a new charging regime we would propose a slower or longer term phased approach to implementation. As with most other transitions proposed for major infrastructure with long investment horizons, a transition period of around 7 years is common and provides the investment community time to absorb changes and restructure appropriately. An approach to implementation aligned with common industry debt terms (~7 years) would go some way to restore investor confidence in the sector, and support those projects with early CM contracts.

As a final observation, Stag Energy are concerned that the model used to support Ofgem's Impact Assessment is fundamentally flawed and no decision should be advanced based on the current assessment. In the first instance, as explained by LCP on 21 March 2017 at the Workshop on embedded benefits modelling, the model assumes "that all capacity granted CM contracts in the previous CM auctions will not renege on these contracts and will deliver as expected."²For the

¹ National Grid Capacity Market Results:

- T-4 2014 CA: ~1 GW new build distribution connected plant awarded 15 year contracts
- T-4 2015 CA: 1.1 GW new build distribution connected plant awarded 15 year contracts
- T-4 2016 CA: ~2.1 GW new build distribution connected plant awarded 15 year contracts

² Workshop on embedded benefits modelling - Assessing impact of changes to network charging arrangements, 21 March 2017, LCP Frontier Presentation

reasons discussed above Stag Energy strongly disagree with this assumption and suspect that as a result Ofgem have incorrectly assessed the risk to security of supply posed by the minded-to position. In addition, through an independent session held with LCP Frontier and the Flexible Generators Group, Stag Energy understand that the model assumes 32% HHV efficient for gas reciprocating engines. This is a factual inaccuracy, the standard efficiency rating for gas reciprocating engines is at least 39% HHV. Correcting only these two obvious inaccuracies in the Ofgem Impact Assessment has the potential to significantly impact the model outputs. Ofgem cannot rely on the current model and must therefore reassess the impact of the minded-to decision.

In summary, Stag Energy urge Ofgem to revisit their minded-to position regarding TDR payments. The current position is based on flawed assumptions and under-estimates the negative impact on consumers of security of supply and short term price volatility. Furthermore, the pace and magnitude of the changes proposed are too great for an industry with development and construction gestation periods of several years.

Stag Energy would support support a cap on TDR payments to allow Ofgem the time to undertake a holistic review of system charging arrangements through a SCR. Alternatively, we would support the proposed cut in EG benefits but if and only if the new charging regime was implemented over a period of 7 years, as is the case with most other transitional charging arrangements for energy infrastructure investments where there are no grandfathering provisions in place.