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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

7 April, 2017

Dear Andrew,

Thank you for the opportunity to respond on the above consultation. This response is made on behalf of Uniper UK Limited.

Uniper is an experienced international energy company focused on power generation, energy trading, transportation, and storage, as well as a provider of specialist power engineering services. In the UK we own seven power stations comprising over 6GW of flexible installed capacity, as well as a fast churn gas storage site. As such Uniper is the fifth largest generator in GB and is making a major contribution to ensuring security of supply and providing a bridge to the energy market of the future.

The main points we wish to make are:

- The current level of embedded benefit significantly distorts the wholesale market and also means that customers pay too much for the transmission network.
- We support Ofgem's minded to position that the current embedded triad benefit of paying small embedded generators the TNUoS Demand Residual should be removed and replaced with an alternative which rewards small embedded generation for avoided GSP costs instead.
- CMP264/5 introduces changes which are a step in the right direction and can be built upon as part of Ofgem's proposed Targeted Charging Review.
- This change should be implemented as soon as possible to ensure that customers benefit to the maximum extent.
- Therefore, we disagree with a phased implementation approach as proposed under WACM4 and believe that option WACM3 should be implemented instead.
- Ofgem's impact assessment has shown that this would benefit customers further by around £200m compared with WACM4, which should outweigh any less tangible concerns about the market participants' ability to adjust to new signals under WACM3's full implementation approach.



Our more detailed comments on the specific questions raised in the consultation document follow below.

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. The current level of benefit provided by paying smaller embedded generators the TNUoS Demand Residual is excessive and far above the real benefit that such plant provides to the transmission system. This creates a significant cross subsidy which distorts the wholesale market, particularly the capacity market.

This means that inefficient investment and closure decisions are highly likely to be made as a consequence of incorrect market signals. It also results in inefficient despatch decisions as plant operates out of merit in order to maximise its triad revenue, even if this means that it makes a loss on energy market revenue. This is certain to result in inefficient wholesale market outcomes which ultimately will increase costs to customers.

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

Yes, the expected increases in TNUoS Demand Residual payments to smaller embedded generators are very concerning. However, it should be noted that current levels are far too high so that they already significantly distort the market. Therefore, action needs to be taken sooner rather than later.

We believe that WACM3 should be implemented as it delivers benefits to customers sooner and prevents further inefficient investment, closure and despatch decisions. We provide more detail on this in our response to question 5.

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

Yes we believe that these have been interpreted correctly.

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

Yes, in general, but we would like to make the following comments on issues raised in this section:

- Although some proposals with smaller levels of embedded benefit could be described as being more cost reflective than the baseline, unless they really seek to reflect the true benefit to the transmission system provided by embedded generation then they are effectively just as arbitrary. Therefore, they should be seen as closer to the baseline in effect than they are to solutions, such as WACM3 and WACM4, which seek to signal the true benefit to the transmission system.
- We accept that preventing the triad payment from becoming negative, as is proposed in a number of WACMs including WACMs 3 & 4, isn't necessarily a

good idea from a perspective of promoting cost reflective charging. However, there are concerns that not doing so could provide a distortion to energy dispatch, whereby plant chooses not to generate against the normal merit order to avoid the triad charge. It seems sensible to follow this approach on balance, but this situation should be reviewed as part of the targeted charging review.

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

Yes. Whilst we agree that the implementation of WACM4 will be better than the baseline in respect of the effect on consumer costs, it is clearly less beneficial than the alternative on which it is based, WACM3.

The present minded to position to phase in the new arrangements will continue to provide a forecast embedded benefit of £49/kW over this period, which is some £45/kW higher than the forecast of the true benefit based on avoided GSP infrastructure savings of £4/kW. This is still a significant distortion which is capable of providing a major contribution to the fixed costs of smaller plant over very short timescales. This means there remains a danger of inefficient new investment and/or inefficient closure decisions, as well as out of merit despatch of plant.

WACM4 is also estimated in the regulatory impact assessment of costing customers circa £200m more than adopting WACM3. We do not believe that concerns about the market being able to adapt to new price signals are sufficiently material or tangible to forego the realisation of this significant benefit to customers.

We therefore believe that WACM3 should be implemented instead, to ensure that customers obtain the full benefit of a change to a more cost reflective payment.

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 this is correct. Introducing grandfathering in these circumstances would contradict the approach that has been taken for other charging modifications. Ordinarily, parties are exposed to the full impact of charging modifications as soon as practicable. This ensures that appropriate action is taken by participants earlier, to the benefit of the market and ultimately customers.

In addition, we note that some parties believe that small embedded generators with Capacity Agreements should have the current level of embedded benefit grandfathered. As a company with a significant amount of plant committed to Capacity Agreements, we understand the risk that TNUoS changes pose under the arrangements. However, no party with such an agreement is currently protected from network charging changes.

Transmission connected generators are also exposed to significant risk of year on year changes in TNUoS charges, particularly given that they have to forecast these 4 years before the relevant Capacity Market (CM) delivery year. We believe that to introduce grandfathering to a subset of CM participants, but not others, would constitute undue discrimination which would be unlawful and contrary to National Grid's charging licence conditions.



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

Yes. This is the only level of embedded benefit which has been demonstrated to exist as a result of a generator being connected to a distribution network. The analysis that has been provided by some parties during the CMP264/5 process, that claims that the level of embedded benefit is actually higher than this, appears to include costs which are covered by the locational element of the charges, such as how flows on circuits or the cost of the network are calculated.

Some of this work may be helpful in assessing whether the current level of locational signal is strong enough, such as a review of the costs which currently go into the expansion constant. However, it does not relate to the benefit of plant being embedded in the distribution network.

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

Yes. This seems reasonable. We do not believe that this modification will pose a significant risk to security of supply. Indeed, we believe that it will lead to security of supply being achieved at a lower cost to customers.

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.

As we mention above, no additional benefit has been demonstrated to exist.

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

No. It would perpetuate a distortion which we believe has already caused significant harm to the wholesale market with inefficient investment and closure decisions, and is currently meaning that customers are paying an estimated £350m per annum too much for the transmission network in order that their suppliers can pay for the subsidy to embedded generation.

We have seen arguments as part of the CMP264/5 process that the CM clears at a lower cost than would be the case without the present cross subsidy in transmission charging. It is argued that this is a good thing which would be lost under CMP264/5. Clearly, it is not the role of the transmission charging methodology to provide an implicit subsidy to another part of the market arrangements. In doing so, it distorts outcomes in both parts of the market which will ultimately lead to inefficient investment and operational decisions, and therefore higher costs to customers.

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

No. We currently receive TNUoS Demand Residual payments in respect of one of our stations. We believe that the arrangements are clear in that charge levels and the basis of charging can change with a change to the CUSC, or indeed with changes to generation and demand levels on the system. As such, we do not believe that we have an automatic right to these levels of payment going forwards.

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

Yes. This seems to cover these elements adequately.

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

No.

Question 14: Do you agree with our modelling approach?

Yes. It seems as good as any. We believe that there is a danger with relying too much on economic modelling as it is extremely difficult to do accurately, for instance as assumptions will always turn out to be incorrect. Nevertheless it can give an indication of the relative interaction between different aspects of a decision, such as the impact on the CM, Energy Markets etc. As such it should be able to provide an indication of the general direction of travel of the effects of a change and the likely scale of the impact.

However, we believe that the modification stands fully on the qualitative impacts of the change. It is clearly correct to remove such a significant distortion from the market.

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

Again, this would seem as good a set of assumptions as any to use.

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

Yes. It is impractical to model each individual WACM. Modelling different ranges of embedded benefit is a sensible approach to understand the general impact of different levels. Given the limitations of economic modelling, it would be unrealistic to try to achieve too high a degree of accuracy in the results.

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

No. We fully support Ofgem's conclusion that the avoided GSP costs are the only benefits that smaller embedded generation provides to the transmission network. However, as we mention above, by introducing phasing the benefits of the change will be delayed to the detriment of customers. Ofgem's impact assessment has estimated this would be at a cost to customers of £200m. We believe that this is sufficient justification to implement WACM3, which introduces the same change, but realises the full benefit to customers 2 years earlier.

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

Yes. We believe that this date is achievable and desirable, so that the distortion caused by the current arrangements can be removed as soon as possible. The change will need a new data flow to be provided to National Grid under the Balancing and Settlement Code (BSC). This is already being progressed under BSC change P348. This information is already provided to the Low Carbon Contracts Company to allow billing of Contracts for Differences costs. Therefore, it should be possible to provide this data to National Grid in time for setting charges for April 2018.



We expect some responses to this consultation will request that this change is put on hold pending the outcome of the Targeted Charging Review which Ofgem announced earlier this month. We do not believe that this is necessary or desirable. As Ofgem has indicated in the consultation for the Targeted Charging Review, this change is needed urgently before a wider review can be delivered. We do not believe that the changes proposed under CMP264/5 will need to be unwound as a result of the review. CMP264/5 introduces arrangements which can be built upon and represents a step in the right direction.

Additionally, making a decision on this modification will help the review and the modifications being assessed currently by providing clarity on what the new baseline is going forwards. If a decision were to be postponed on CMP264/5, pending the review, it would actually be more difficult to put together proposals and legal text for any subsequent modifications as it would not be clear what baseline should be built upon.

I hope the above comments prove helpful. Please contact me in the first instance should you wish to discuss any of these points further.

Yours sincerely,

Paul Jones
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Uniper UK Limited