



Frances Warburton
Ofgem
9 May 2017

Dear Ms Warburton,

Ofgem's Targeted Charging Review Consultation

Green Frog Power builds gas-fuelled power stations utilising reciprocating engines. Efficient and flexible, our plant is exactly what the market needs. We have built more capacity that is reliable than any other British company in the past five years. We have 430MW of plant in operation and a construction pipeline exceeding 600MW. The entire fleet can start from cold in less than two minutes.

We welcome the opportunity to respond to Ofgem's Target Charging Review consultation.

It has been clear for some time that the rapidly increasing demand residual is unsustainable. The reason for the increase in its cost is unrelated to the actions of embedded generation. It has been caused by:

- increases in transmission expenditure due to renewables policies,
- an EU cap on the generation residual,
- reduced transmission demand and
- falling transmitted generation.

All these issues should be addressed in Ofgem's Targeted Charging Review (TCR), or Significant Code Review (SCR).

It is very important that this full review is done as fairly and as thoroughly as possible to minimise the potential for ongoing and perpetual avoidable distortions and as well as resource intensive code modifications.

The process should be planned and led by an uninterested party to ensure a fair voice and consideration is given to parties of all shapes and sizes.

Yours sincerely,

Graz Macdonald
Head of Regulatory and Policy Analysis
Green Frog Power Limited

Ofgem Targeted Charging Review – a consultation

Question 1: Do you agree that the potential for residual charges to fall increasingly on groups of consumers who are less able to take action than others who are connected to the system, is something we should address?

The issue of the rising consumer burden and distributional impacts is due to the rapid and dramatic increase in the demand residual. We think it is fair and reasonable to address the rising residual pot in terms of the reasons for its increase:

- Increased rate of growth of transmission network expenditure (primarily) due to government policy to increase renewable generation. This requires that generation be located away from demand in many cases.
- The European Union cap on the amount of the residual that can be charged to transmitted generators
- A reduction in transmitted generation levels due (primarily) to renewables growth

The combination of these effects has meant that there has been an increasing level and share of the fixed and sunk transmission costs that consumers must ultimately pay.

The ever-increasing triad is neither sustainable nor reasonable. A perpetually increasing residual charge is particularly unfair to those consumers who are unable to act to avoid the charges. But we think that the attention should not be taken off the reasons for the increase when undertaking a wider-view consideration of a potential solution.

Question 2: If so, why do you think, or do not think, action is needed?

Action is clearly required to stop the rapid increase in the demand residual. Without a full analysis of the potential implications, which would be undertaken in an SCR, it is impossible to say what level of residual is appropriate – other than possibly at the current level.

Question 3: We are proposing to look at residual charges in a Significant Code Review. Are there any elements of residual charges that you think should be addressed more urgently? Please say why.

It became obvious during the CMP264/265 work that there is little understanding of precisely what costs, sunk or otherwise, are included in the demand residual. It appears to be difficult, if not impossible, for a bystander to ascertain the costs in the pot – all we know is that Ofgem have approved the amount for National Grid to collect through the price control review – which process and detail appears to be opaque and “too difficult” to unwind and was considered “off limits” anyway.

Question 4: Are there elements of the approaches in other countries that you think could be appropriate for GB residual charges?

N/A

Question 5: Are there other approaches that you know about from other jurisdictions, that you think offer relevant lessons for GB?

N/A

Question 6: Do you agree that our proposed principles for assessing options for residual charges are the right ones? Please suggest any specific changes, or new principles that you think should apply.

The principles underpinning an SCR are very important, and in general, we think Ofgem have identified the key elements that should provide the appropriate underpinnings of the SCR. Specific comments are below.

Reducing Distortions – This is clearly a key issue, particularly in this heavily regulated market. Like a balloon, where one reduces a distortion here, another appears elsewhere. Ofgem are correct to take a wider view of the overall merit (or not) of these distortions. We think it is important to ensure that consideration is taken of whether one “distortion” has the effect of reducing another “distortion” in another area of the wider market. For example, where peak pricing and market access and peak liquidity is sub-optimal (which impacts on consumers’ overall costs), then triads serve a useful purpose in addition to reduced transmission network investment. It is critical that a whole-earth perspective is taken in this regard.

Fairness – Ofgem correctly states that everyone has a different view of fairness. In our view, if a regulatory design unfairly benefits or penalises certain stakeholders, then it is almost certain that the system will not be sustainable. Therefore, we think it is very important to take into consideration the distributional impacts of the increases in network costs, including why they are increasing, as noted in our responses to previous questions; the impacts on overall consumer well-being (not limited to costs); and to the general effectiveness of the energy and capacity markets and the investment climate. It is a complicated balancing act but if we want to attain a stable outcome, very important.

Proportionality and practical considerations – These are important principles. Predictability and simplicity are very nice to have. It is also important that the residual recovery method is designed to be robust to future technologies or behaviours that are currently unthought of. This market is evolving quickly and everyone will face the consequences of costs, distortions and regulatory risk if the solutions are not able to endure.

We note that the solution for ensuring collection of the demand residual would be most effectively done through the tax system. This method would achieve these principles, and would also be conceptually correct for the portion of the demand residual that is directly attributable to government policies to achieve renewables and low carbon targets.

Question 7: In future, which of these parties should pay the transmission residual charges: generators (transmission- or distribution-connected), storage (transmission- or distribution-connected), and demand, and why? What proportion of these charges should be recovered from each type of user?

It is too early to propose the correct response to this question. This should be an outcome of the SCR process.

The concept of fairness and “a level playing field” should underlay this analysis and care should be taken to ensure that inconvenient aspects are not ignored or “assumed away” as a way of achieving a sooner but perhaps incomplete or inappropriate answer.

Question 8: In future, which of these parties should pay the distribution residual charges: generators (transmission- or distribution-connected.), storage (transmission- or distribution-connected), and demand, and why?

What proportion of these charges should be recovered from each type of user?

As above.

Question 9: Do you support any of the five options we have set out for residual charges below, and why?

The purpose of the SCR process should be to ascertain which option for collecting the residual charges is most appropriate.

It is important that behind the meter generation be treated the same as other embedded generation to avoid perverse incentives.

Question 10: Are there other options for residual charges that you think we should consider, and why?

Since a good portion of the increase in the residual charges is directly due to government policy to increase renewables generation, we think that the appropriate proportion of network costs should be allocated to this policy.

This would mean that either renewables should pay for the increased costs due to their remote locations or that the tax payer should pay for the social good that the policy is intended to achieve.

Attempting to recoup policy costs through an industry charge necessarily has adverse distributional impacts. Income tax would be the least regressive approach, though council tax would be a close second. We note that there is already precedent for the collection of fixed infrastructure costs through council tax (water charges) so this is not a radical notion.

The increased costs in this case would cover not just the connecting to the transmission network or local reinforcements, but the large north-south lines and other related expenditures that would not be required in the absence of renewable development.

The remaining residual pot would then remain a similar size as what it has been over the previous decades. This approach would provide fairness and stability to all parties and avoid undesirable impacts on particularly vulnerable consumers.

We recognise that Ofgem does not have the remit to impose a tax in this way, but we urge Ofgem to approach the appropriate government parties to consider this as the most effective and efficient solution to a very complex issue. We do not think that any of the solutions proposed in this consultation will sufficiently address the societal problems associated with an ever-increasing residual pot.

Question 11: Are there any options that you think we should rule out now? Please say why.

We have asked for a thorough review and study of this issue to ensure that all parties have fair and balanced treatment. We do not think it is appropriate to rule out any feasible solutions at this early stage.

Question 12: Do you think we should do further work to analyse the potential effects of the charging arrangements for smaller EG (called 'embedded benefits')?

Yes. It is not clear to us that the benefits of embedded generation are being fully considered in terms of the benefits they bring the system. As embedded generation is usually located closer to demand (other than northern renewables) it is not clear that the locational signals are sufficient to cover the costs of locating farther away from demand.

We note also that costs across both the transmission and the embedded side should be considered in terms of how generators are exposed to the direct costs of connecting. It seems clear that if embedded generation has an impact on the transmission system then the opposite is also true that transmitted generation has an impact on flows on the distribution network.

This must be looked at in a thorough and holistic way before any assumptions can be made about the correct, most fair and least distortionary solution.

Question 13: Do you think changes are needed to the current charging arrangements for smaller EG, and when should any such changes be implemented?

This decision should be an output of the SCR process.

Question 14: Of the embedded benefits listed in our table, do you think that any should be a higher or lower priority?

A holistic analysis taking all elements into consideration at once is necessary to avoid making costly mistakes and having to revisit specific areas time and again.

Question 15: Do you think there are other aspects of transmission or distribution network charging which put smaller EG, or any other forms of generation or demand, at a material disadvantage?

We are aware that work is ongoing in terms of improving embedded generation connection queuing, though we are not yet convinced it is improved enough to be on par with connecting to the transmission system. This work should be taken into consideration in the SCR. It appears to be the case that distribution connected generators are exposed to much higher up-front costs and risks to connection timelines than transmitted generators. These added costs and risks are not insignificant.

We note also the work underway to develop a DSO approach to distribution system management. We are hopeful that this will enable smaller generators to monetise the value of their assets and help to optimise network investment costs. For example, distributed generation is not paid for provision of constraint management services. This is a clear disadvantage as compared to transmitted generators.

Question 16: Do you agree with our view that storage should not pay the current demand residual charge, at either transmission or distribution level?

N/A

Question 17: Do you agree with our view that storage should not pay BSUoS on both demand and generation?

Yes.

Question 18: Which of the BSUoS approaches describe is more likely to achieve a level playing field for storage?

This should be an outcome of the SCR process rather than viewed as a predetermined outcome.

Question 19: Do you think the changes in this chapter should be made ahead of any wider changes to residual charging that may happen in future? Do you agree with our view that these changes should be implemented by industry through the standard code change process?

We are concerned about the standard code change process. It has been demonstrated to be unfair and one-sided. Furthermore, it has been blatantly used as a weapon by industry incumbents against market entrants, which we do not believe is the intent nor desirable as industry practice.

Therefore, we strongly urge that all changes are taken in context of each other and in the context of broader market measures including market access, market liquidity, credit requirements, cash out reform and ancillary services. The standard code change process does not allow for these wider issues to be taken into consideration and will therefore result in a siloed and potentially sub-optimal outcome.

Question 20: We would welcome your thoughts on the potential make-up of a CCG. Please refer to the potential role, structure, prioritisation criteria and assessment criteria.

The make-up of the CGG is critical to the success of the SCR. We (and we believe others) have commented on the unbalanced make-up of the CUSC panel. Without intending to cast aspersions of the professionalism of the individuals involved, we think that despite best intentions and efforts, it is

unrealistic to believe that these individuals will be able to vote directly against the interests of their employers. This is particularly true on issues of material strategic or financial importance to the respective companies (as the embedded benefits issue has become).

We think it is likely that the CUSC panel members who bring forward CUSC modifications have the consent of their respective Boards, and that to subsequently vote against these Board approved strategic actions would require either voting anonymity (which we do not recommend) or uncommon strength of character and personal conviction.

In our view the only effective way to ensure that the decision panels make an overall balanced decision is for the panel to have a wide variety of participants – i.e., not mainly just the “big six”.

These comments apply equally to the make-up of the CCG. It must have a balanced make up of individuals representing all segments of industry and consumers.

In addition, it is important that the resource requirements are known in advance for all participants. It may be the case that a truly independent and uninterested support team may need to be contracted for the duration of the group’s existence.

These parties could be used to ensure that communications and documentation, and perhaps analysis, is unbiased and complete. Many smaller individual companies will struggle to match the resources available to larger corporate interests. Even if people are nominated to represent these smaller firms, the market is now emerging as increasingly diversified – this means that there is the potential for the larger parties to have a more joined-

up voice against the numerous, likely conflicting voices of the many and more-diverse smaller parties.

The comments above indicate our concern for how this groups will work in practice. We recognise that it is a very difficult issue to address and we are appreciative that the intent of the group is to deal with these matters. But, very careful thought must be given to the practicalities of how this group will operate and this group will manage long and potentially ongoing discussions about numerous complicated and interrelated issues.

Question 21: Do you agree with our proposed delivery model, including its scope?

We agree with the proposed delivery model for the SCR. We wish to reiterate the importance of considering the residual charges in the context of other distortions, shortcomings and developments in the wider electricity market place. Our concern is that if the focus of the SCR is too narrow (and relevant issues are regularly identified as out of scope), then we shall be revisiting these issues again soon – potentially even before the SCR is complete.

This is subject, of course, to practical limitations. The CCG could manage this issue as required rather than being overly prescriptive and limiting about what should and should not be taken under consideration in the SCR.

Question 22: Do you agree that our proposed SCR process is most appropriate for taking forward the residual charging and other arrangements for smaller EG discussed in this document?

Yes.