

Andrew Self
Head of Electricity Network Charging
Ofgem
9 Millbank
London
SW1P 3GE

5 May 2017

Dear Andrew

Targeted Charging Review

Introduction

The Flexible Generation Group (FGG) represents the owners of and investors in small scale, flexible generation. These power stations are embedded in distribution networks and provide a variety of services to the system operator to help it deliver secure, economic supplies to electricity customers. While not a new sector in the market, it is becoming increasingly vital that the SO has access to flexible generators to help maintain system security in the most economic manner. All of the FGG businesses are and/or are impacted by the charging regimes of both the TOs and the DNOs.

FGG, in our response to Ofgem's IA on CMP264/5, has made it clear that we support a SCR, rather than a TCR, on charging. We do not believe that looking at only part of the charging regime can result in the most economic and efficient regime for the future. While recognising that this is a substantial piece of work, we are concerned that unless Ofgem undertakes the necessary work to properly address the issues with the current charging arrangements then the industry will have to make further changes in future years.

Wider Issues

We have commented on the principles that Ofgem set out in chapter 5 below, but want to note that Ofgem must be careful not to consider transmission charging in isolation. FGG have raised with Ofgem our ongoing concern about lack of economic market access for smaller generators. If Ofgem removes income streams from some parties, such as our members, without creating different routes to market, it will not achieve an economic solution for customers. The energy markets are a complex set of interlocking market arrangements, with multiple charges and income streams. Ofgem must be mindful of this as it carries out its review and promote parallel market changes which will complement any changes to monopoly charging.

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?

FGG agree in principle that customers who use the transmission network at any given time should make some contribution to covering its costs. However, increasing standing charges, reflecting the right to use the system, can be regressive. Ofgem will therefore need to consider the impacts on social and industrial policies¹.

The system of charges, resulting from the Transmission Charging Model, are not well designed to reflect the growth in renewables. Ofgem also raises concerns about the incentives that charges create, which we agree are a problem. However, to address these issues Ofgem need to consider not only how the residual charge is levied, but the locational charges regime. They are right to be concerned that the residual element may dilute locational charges.

Ofgem is right to note that some parties will respond to increasing transmission charges, investing in batteries, on-site generation, etc. However, they should not look to discourage these actions as they are both economic and in line with government policies. Which then raises the question about whether, in the longer term, the TO networks are the right size and if the cost benefit analysis for large, expensive new connections or reinforcements are in fact in the interests of customers. That is not to suggest that they are not in the interests of achieving government policies, but they may be better supported by tax payers than energy customers, at least in part. It remains a fact that energy producers located close to customers provide more economic, secure supplies.

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

FGG believe action to address the charging regime as whole is needed as it is no longer fit for purpose. It does not send the right signals to those connecting to and using the network. However, Ofgem needs to consider why the costs of the TOs in particular are rising. FGG feel that the biggest driver is investments to connect renewables, in particular offshore wind, usually large distances from consumers. This is a direct result of government policy and could be argued has been done to the benefit of UK plc, not GB electricity customers in particular. However, it would be helpful if the extra revenue that the TOs require to transport energy from remote renewables is explicitly charge rather than hidden in the demand residual charge. By being explicit about the costs of connecting remote renewables, helps the industry make economic decisions between large remote renewable projects with the associated cost of transmission and smaller local projects without the same need to invest in transmission infrastructure.

The problems with the charging regime go wider than who pays the residual. Ofgem needs to examine if the locational charges are as cost reflective as they assert and potentially adjust them before they decide how to deal with the residual. The work done by some parties, in response to the IA, shows that the locational charges are not cost

¹ For example the government's targets on fuel poverty and protection of ELLs from the costs of environmental policies, with much of increasing TO costs being a direct result of renewables investments.

reflective. Furthermore, the charging regime and investment regime seem to have become decoupled, with network investments no being achieved in a timely manner. There are therefore issues around the interaction charging "signals" and the price control's incentives on investment.

Having established whether the cost increases are really economic, Ofgem should look at whether the size of network being built, and where it is being built, is the best long term solution of UK plc. It can then ask who should pay and how. For example, if offshore wind farms are creating the largest cost it would be better if the costs are put more squarely on them, increasing the costs of CfDs, but spreading the cost across all customers in relation to their use of energy. This may be a more equitable way to fund increasing renewables costs.

FGG also believe that the charging review should consider connection charging as well use of system charges. The connection regimes feed into locational decisions made by investors and into the network developments. Despite numerous investigations into the connection regime, Ofgem's initiatives have to date made little difference to the ease, timeliness and cost of connections in the DNOs' networks. Ofgem cannot create a level playing field between connecting parties until they face comparable connection regimes.

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.

FGG has nothing to add to the points made in our response to the CMP264/5 IA.

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

Ofgem's analysis has focussed on the residual, and as noted above, FGG believe that a wider review is needed. Of the options set out all have pro and cons, with different distributional impacts. While some parties may be able to avoid some costs, it will be the overall cost of the monopoly charges, combined with energy and levies on bills that will ultimately drive parties "off-grid".

Ofgem has to consider if there are time of use signals that are still appropriate; do the TOs want load reduction/EG at peak? If so those signals must be easy for customers/EG to understand and respond to, as the Triad has been. Generally government policy has been to reduce energy consumption, with smart meters justified on energy savings. Ofgem will have to be careful if it therefore proposes to place a high fixed charge on customers, making energy savings from load reduction less rewarding. In setting fixed charges, Ofgem will also have to consider the size of connections may be historic, with meters or fuse sizes out of step with the customer usage. Ofgem should also consider if it is charging for infrastructure that actually exists. It is easy to say that a domestic customer has a 100A fuse therefore they should pay for a 100A connection. However, if all customers in a street were to simultaneously take 100 A, it is unlikely that the local network would be able to deliver this capacity.

FGG agree that communication and transitional arrangements will be important in a move to a new charging regime. As we have pointed out in response to the IA, investors have acted in good faith to bring forward new investments (both in generation and demand) and investor confidence must not be undermined. It is important that the impacts on competition are fully considered.

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

FGG believe Ofgem and BEIS need to discuss if the costs of environmental policies are best paid by electricity customers or if tax payers should make a contribution.

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.

FGG agree that parties should compete in markets with as few distortions as possible. This means in all markets, and there is a specific need to break down barriers to smaller parties entering the wholesale energy market.

We noted that there is always a balance between the principles underlying any given choice over charging regimes. We fully support the principles of simplicity, transparency, stability and forecastability. NG's five year forecasts of transmission charges are very helpful, but generally parties would like to see greater stability in monopoly charges, to help with planning and create stability for customer bills.

While Ofgem's principles look broadly sensible, they should not make any decisions without robust analysis. We have been concerned that Ofgem's IA on the recent charging modifications made a considerable number of assertions without robust analysis. We very much hope that Ofgem are addressing the defects identified with its model and will therefore be in a position to better understand the impact of their policies on the market.

We are also particularly concerned that the results of policy changes must not undermine the business case for investments made in good faith. Ofgem's analysis of the CUSC mods seems to suggest that it would be acceptable to put some company's assets at risk, which is deplorable, especially where those investors acted against what appeared to be a stable investment background.

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?

Parties who use the networks should pay for them. We would note that this arguably means that large generators should contribute to the DNOs' networks as they use them to get energy to their customers. However, parties that reduce the network costs, or support the network should be compensated for those services.

While this is a GB review, we believe that if Ofgem is serious about minimising distortions it should also address the interconnector flows. At the present time some EU states see their generators pay no transmission charges, nor any charges for use of the interconnectors, and are exempt from paying carbon tax. They therefore have a distorting competitive advantage and are able to undercut the GB generators. These may be issues that could be dealt with after Brexit, as it is undoubtedly creating a market distortion and it is one that will grow with further interconnection.

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?

Ultimately customers will pay all of the costs of energy production and transportation, the question is whether they pay directly or indirectly? Charges may be used to try to influence behaviour, such as power plant locations, but as Ofgem note the locational signals are watered down with such large residual payments. As part of the wider review, Ofgem should identify which signals could be usefully given to all parties from network charges and then create a suitable charging structure to encourage efficiency in the market.

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

FGG believe that Ofgem should examine all of the options and model the distributional and competitive impacts of the various options. While we suspect that a hybrid approach will be needed, it would be wrong to rule anything in or out without robust analysis.

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

No.

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

No.

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')?

As noted before, FGG would like to see Ofgem look at the other distortions impacting EG. For example, we cannot connect when and where we want to; there is no connect and manage regime. When we do connect a site the DNO can require a lot of controls (installed at our expense) to allow the connection. If the DNO or NG then have an issue in a specific area they may just take our plants off; with no constraint or intertrip type payments. We have experienced instances where the DNO calls NG and asks that our sites are not called for system reasons, again with no compensation.

EG does not have proper access to the wholesale market, via the BM. Ofgem is aware that the FGG want to raise a BSC change in order to facilitate BM access for smaller plants, but have not yet been allowed to do so by Ofgem (we requested this in mid March). The market access issue must be resolved if the smaller generators are to be able to compete on a level playing field.

We are concerned at the increasing levels of apparent bias that Ofgem appears to favour large transmission connected generation. It would help our concerns if Ofgem could take actions to show that its perception is misplaced.

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

As noted above, Ofgem seems to be focusing on the residual and BSUoS as embedded benefits that they feel are wrong. As the owners of embedded plants, we know that the issue of distortions goes far wider than the issue of Triad payments.

It is important that Ofgem address the greatest distortions in the market in a holistic and timely manner so that all plant types really can compete fairly against each other. In particular, FGG would like to see Ofgem ensure EG has:

- Access to the wholesale energy and balancing market which would ensure that, while there is no direct disincentive not to run at peak times, would facilitate economic running at peak times;
- The structure of connection charges, notably the issues around statement of works where DNOs then request gencos pay for wider reinforcement of the TO networks must be stopped;
- The lack of ability to compete in all ancillary services markets must be resolved;
- The right to raise changes to all codes that can directly impact on embedded generators' assets and business interests must be easily realised in practice not just theory; and
- Removal of charges on energy used on embedded sites including ROCs, CfD, FITs and in the longer term CM charges, so the costs of EG gencos align more closely with their larger competitors.

FGG agree that there is a good case for reviewing BSUoS, but it is less obvious that this should be done as part of a SCR on monopoly transportation charges. There seem to have been many proposed changes to BSUoS in recent years, with Ofgem not appearing to be minded to accept the proposals to date. FGG therefore feel that it would be much better for Ofgem to request that a review is led by a third party (freeing Ofgem staff to work on monopoly network charges). While naturally a review should sit with National Grid, we do not believe that they would be perceived to run an independent review. If BSC parties agree, Elexon may be better placed to facilitate a review using the process adopted by BSC Issues groups. As BSC parties are all impacted by BSUoS it seems likely they would support such an independent review.

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

While the table identifies the embedded benefits this is only half of the equation, not all EG will benefit from the elements outlined, and those that do will benefit to differing degrees. There are also disbenefits, with associated costs, faced by EG which include:

- A deep connection regime;
- No payments for connection management or constrained off-payments;
- Lack of market access;
- No access to some ancillary services markets;
- Barriers to raising market rule changes; and
- Payment of green levies of won energy use.

Ofgem needs to think about how it creates a level playing field, not just how to tip the playing field in favour of larger plants.

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?

See above.

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

Storage needs to be defined as demand or generation and then pay the appropriate charges. FGG sees no reason that storage should have special treatment in terms of use of system charges. We recognise that storage will be able to offer system support services to the DNOs, or TO, as other technologies can and these services can be directly procured on a competitive basis. We feel logically treating storage like generation would make sense, as it will largely compete with generation.

There is a logic that storage should pay the residual when it charges (fills) and be paid the residual when it discharges (therefore be treated as negative demand), such that the effect is that storage only pays the residual on its net consumption.

For example:

- i. If a perfect (100 % efficient) storage drew 100 MWh off the network and then exported 100 MWh back to the network, it would face no residual charge; however
- ii. If a low efficiency storage drew 130 MWh of the network buy only exported 100 MWh back (30 MWh being lost in storage inefficiencies) then it would face a residual charge for 30 MWh of demand.

This would also create a level playing field with behind the meter storage.

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

Once storage is defined as being in a specific market it should pay charges appropriate to that market. We support cost reflective charging and that means it may be appropriate for storage assets should pay BSUoS (or some elements of it) on both energy in and out, as both energy flows will create some costs. However, as noted above, FGG believe that there is a good case for a full review of BSUoS and therefore the decision on should pay what should not be taken until after that review is carried out.

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

As noted above, we believe that BSUoS does need a review, but this could be led by the market. Ofgem should ask a group to identify:

- What is in BSUoS;
- Who benefits from each of the services and should therefore pay;
- Should each cost more logically be charged on a fixed (site/meter/capacity) basis or a MWh basis;
- Where a fixed charge seems more appropriate what is the best way to charge (per meter, fuse size, etc.);
- Can some of the charges be notified in advance and fixed for say a year; and
- How does any under/over recovery get dealt with.

Much of the leg work has been done on some of these issues under the CUSC mods recently considered². Recognising that parties will have a range of views on the most appropriate regime, they could present a range of options in a report to Ofgem, who could consult more widely before the necessary mods are raised.

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?

FGG members are small companies. The changes required to create a more competitive market for the future needs of customers, better facilitating the changes in the generation mix and customers demand are substantial. We have therefore tried to identify some routes to get the work done in a way that would allow the right "experts" to support policy development, but also creates some manageable work streams. We therefore believe that the changes should be addressed in the following manner:

² CMP201 - Removal of BSUoS Charges from Generators

CMP208 - Requirement for National Grid to provide and update forecasts of BSUoS

CMP250 - Stabilising BSUoS with at least a twelve month notice period

CMP262 - Removal of SBR/DSBR costs from BSUoS into a 'Demand Security Charge'

CMP267 - Defer the recovery of BSUoS costs, after they have exceeded £30m, arising from any Income Adjusting Events raised in a given charging year, over the subsequent two charging years

- Changes to storage can go ahead in a more timely manner than any other changes identified and needs to be led by Ofgem and BEIS;
- A full review of monopoly charges should be undertaken by Ofgem via a SCR, ensuring it addresses ALL monopoly charging issues including connections;
- FGG should be allowed to raise its BM Lite change to move forward market access in parallel to the SCR under BSC governance; and
- BSUoS should be reviewed by the market with a report back to Ofgem.

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.

While we are slightly clearer about the role of CCG after Ofgem's workshop, we are still not sure what sort of expertise Ofgem is looking for; charging experts or wider business experience?

What will be important is that it is an open and transparent group, with papers published in good time for the market to feed comments in. It must also contain representatives from all impacted sectors, including the wide range of EG businesses. We have been concerned that Ofgem refers to EG, but in reality the economics of different types of EG need to be considered. Ofgem therefore need to include peaking plants, RO, CfD, on-site and CHP.

We would note that the connection regimes have already diverged, with different types of EG being treated differently; wind can connect in South Wales but conventional plant cannot. These issues cannot be addressed by narrowly defined CUSC mods and groups that lack experts in these types of issues. This is why they must be addressed in a more wide ranging SCR.

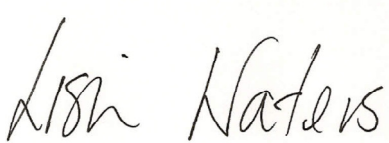
Question 21: Do you agree with our proposed delivery model, including its scope?

It seems reasonable, but Ofgem will have to keep a check on the ability of smaller parties to play an active role in the process. We also suggest that the workgroups should be preparing the details of the mods so as to not duplicate discussions and efforts with the subsequent mods process.

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?

As noted above, we believe that the work needs should be split out into some distinct projects. However, most importantly, Ofgem's SCR must cover the whole charging regime and it must progress work on other distortions in parallel. We would not want to see changes in say embedded benefits coming in before wider market access has been secured for EG. We appreciate the work involved, similar to NETA, but we need to make a step change to make sure the market is fit for the next 20 years.

Yours sincerely



Flexible Generation Group
Gables Lodge
62 Kenilworth Road
Leamington Spa
CV32 6JX

Telephone: 020 8239 9917

Lisa Waters
lisa@waterswye.co.uk
On behalf of:

Mark Draper
CEO, PeakGen Power

Matthew Tucker
CFO, Welsh Power

George Grant
Director, Prime Energy Ltd

Mike Davies
Director, Eider Power

Graham White
CEO, Mercia Power Response

Paul Jenkinson
CEO, Alkane Energy

Paul Barker
Investment Director, Oxford Capital