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Ørsted response to the Ofgem Targeted Charging Review

Our ref. ANDMH/TCR

The Ørsted vision is a world that runs entirely on green energy. Ørsted develops, constructs and operates offshore wind farms, bioenergy plants and innovative waste-to-energy solutions and provides smart energy products to its customers. Headquartered in Denmark, Ørsted employs 5,600 people, including over 900 in the UK. Ørsted is the largest offshore wind farm developer, generator and owner in the UK, and the world. Our supply business offers flexibility solutions to our industrial and commercial customers as well as supplying them with electricity and gas.

We welcome the opportunity to respond to Ofgem's Targeted Charging Review (TCR). We view the wide range of decisions within the TCR to reform network charges to be impactful on our generation business as well as our ability as a supplier to help customers to be more flexible with their demand. The proposed minded-to changes to the residual charge, removal of embedded benefits, and review of BSUoS charges will cause significant changes in the structure of network charging and our views on investor confidence in new and existing projects and services.

As part of our vision, a flexible energy system forms an essential part to a decarbonised power sector. The ability for customers at all levels to be able to offer system benefits from various forms of demand side response is a key component to not only decarbonisation, but to system planning and avoiding network reinforcement.

Reform to residual charges neglect the value of flexibility

Whilst we agree with the definition and purpose of a residual charge, we are concerned that proposed changes do not sufficiently consider flexibility as part of the process, which will lead to harming investor confidence in providing these services. The recent Smart Systems and Flexibility Plan (SSFP) update¹ from BEIS and Ofgem state commitments to 'making markets work for flexibility' as it is becoming 'increasingly central to this transforming system', a view which is not presented within the TCR. The provision of flexibility services supports the Secretary of State's 'insurance' principle on preserving optionality given the

¹ Published 16 October 2018 on gov.uk

intrinsic uncertainty about the future², which the TCR reform to the residual goes against.

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The removal of the triad from demand side of residual charges and replacement with a Fixed or Agreed Capacity charge may address principles of fairness with the treatment of the residual by spreading the cost of the residual more evenly. However, the TCR does not propose how to replicate the value that the existing framework provides to the system in terms of flexibility services that are being provided.

We acknowledge Ofgem's intent to resolve this issue partly with the recently announced Access Reform Significant Code Review (AR SCR). However, by producing a minded-to TCR decision with an open-ended consultation on Access Right reform, customers and suppliers are not offered clarity on whether technology already deployed or future deployments will become stranded assets.

The provision of flexibility services remains at an early stage in its development, and we urge for further support to realise a sustainable, long-term market for demand side response and other flexibility services. Whilst consultation on the TCR concludes, we still welcome efforts to closer align the TCR and AR SCR work streams (e.g. the use of a shared analytical baseline to align the study of likely impacts) to produce a more holistic outcome. The closer alignment between the two sets of reviews would allow us to comment further on reforms to the residual and all charges within a wider context.

On the generation side, the current trend of an increasingly negative charge was seen as a way to maintain compliance with a €2.50MWh cap on generator charges³. In setting the residual for generators to zero, we would appreciate further information to be made available on how the cap on generator charges will be maintained in future years. We would like to see a clear, phased pathway on these changes so that we can maintain predictability in charges that supports businesses by reducing volatility at a time of substantial change.

These substantial changes to network charges have come from many Ofgem reviews in the last 18 months. As well as the TCR, we have participated in the AR SCR via the Charging Futures Forum, and we are forming our views on the upcoming RIIO-2 price control. All of these substantial reforms that affect use of system charges are due to be implemented at various points in the period 2021-2023, and it will be important for changes that are being introduced to be done in an aligned manner. For example, if the overall intent is to remove cost-reflective actions from the residual portion of charges whilst creating flexibility within the AR SCR's review of forward-looking charges, it would make sense to pay close attention to implementation timings that maintains flexibility to address concerns over network user investments.

² Secretary of State Greg Clark's speech '4 principles for the power sector' from 15 November 2018

³ As per regulation EU 838/2010

Reforming embedded benefits provides equal treatment for generators

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Lastly, proposed reviews of embedded benefits related to BSUoS charges that can align the treatment of all generation technologies to produce a level-playing field make sense. The current framework groups decentralised generation largely as negative demand as opposed to generation which is exporting into the system. The arising difference in treatment offers benefits to embedded generators that transmission connection generation are not able to access.

We have set out our views in more detail in the appendix overleaf, which contains our answers to the questions in consultation. Please do not hesitate to contact me (andmh@orsted.co.uk, 07827 283123) should you have questions about our response.

Yours sincerely,

Andrew Ho

Senior Regulatory Affairs Advisor

Ørsted

Appendix – Response to consultation questions

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1. Do you agree that residual charges should be levied on final demand only?

Yes. We agree with the rationale offered under section 4.3 of the consultation document.

We would like to point out the Transmission Generation Residual (TGR) has in recent years been used to maintain compliance with the €2.50/MWh cap on generator charges under EU 838/2010. It will therefore be important for Ofgem to clarify how it intends to maintain compliance with EU838/2010 and give generators adequate notice of these proposals that allow for the required industry scrutiny to avoid unintended consequences of new measures.

The process for setting the TGR to zero should therefore be a phased process to allow for sufficient time for an alternative to be implemented in a thoughtful manner that considers all other network reforms such as the Access Rights Significant Code Review (AR SCR) and inclusion of structural changes to TNUoS that new price controls under RIIO-2 may introduce.

2. Do you agree with how we have assessed the impacts of the changes we have considered against the principles? If you disagree with our assessment, please provide evidence for your reasoning.

We agree with the principles of the residual against which the assessment was performed.

3. For each user, residual charges are currently based on the costs of the voltage level of the network to which a user is connected and the higher voltage levels of the network, but not from lower voltage levels below the user's connection. At this stage, we are not proposing changes to this aspect of the current arrangements. Are there other approaches that would better meet our TCR principles reducing harmful distortions, fairness and proportionality and practical considerations?

We have no firm views on this at this time.

4. As explained in paragraphs 4.41, 4.43, 4.46, 4.49, 4.80, we think we should prioritise equality within charging segments and equity across all segments. Do you agree that it is fair for all users in the same segment to pay the same charge, and the manner in which we have set the segments? If not, do you know of another approach with available data which would address this issue? Please provide evidence to support your answer.

We do not disagree with the principle of the residual being an equitable charge to provide cost recovery for sunk costs. However, we see a need to consider proportionate charges for network users who can provide a benefit in system planning and future avoided reinforcements.

In this regard, section 4.45's reference that 'taking such actions (such as triad avoidance) result in lower residual charges but does not bring reduction in system costs' is a narrow reference. It neglects benefits that flexibility brings in reducing overall system constraint and its potential in avoiding network reinforcement.

Without the ability to see what changes will be introduced within the AR SCR, it is difficult for us to be able to comment on whether the proposed solutions in the TCR represent a proportionate response that addresses not only consumer value, but flexibility. We are unable to clearly support a Fixed Charge option or Agreed Capacity option without seeing how access rights and forward-looking charges are reformed that continues to build a flexible grid.

5. Do you agree that similar customers with and without on-site generation should pay the same residual charges? Should both types of users face the same residual charge for their Line Loss Factor Class (LLFC)?

Again, we do not disagree that as a cost-recovery charge, the residual should be distributed in an equitable manner. However, there must be recognition for the value of providing flexibility services that DSR services, which may include onsite generation, bring to the system.

The TCR's minded-to decision removes a lot of this value without accounting for how flexibility benefits can be recognised within the cost-reflective portion of charges. Whilst we acknowledge that the AR SCR seeks to resolve this question, the structural disparity between the TCR and AR SCR presents issues that harm investor confidence for flexibility providers.

Running a minded-to TCR process that imminently removes flexibility and having an open-ended AR SCR that may not guarantee an effective replacement flexibility signal presents a risk to 'making markets work for flexibility', which is referenced in the BEIS/Ofgem Smart System and Flexibility plan. Furthermore, the difference in proposed implementation dates between the two dates further harms confidence in seamless solution that provides continuity in offering this system benefit.

6. Do you know of any reasons why the expected consumer benefits from our leading options might not materialise?

Implementation of a Fixed Charge or Agreed Capacity charge may enhance the equity and fairness of the residual charge, but as per questions 4 and 5, we are concerned about the effects of these reforms on flexibility services.

7. Do you agree that our leading options will be more practical to implement than other options?

We have no firm views on this at this time.

8. Do you agree with the approaches set out for banding (either LLFC or demanding for agreed capacity)? If not please provide evidence as why different approaches to banding would better facilitate the TCR principles.

We have no firm views on this at this time.

9. Do you agree that LLFCs are a sensible way to segment residual charges? If not, are there other existing classifications that should be considered in more detail?

We have no firm views on this at this time.

10. Do you agree with the conclusions we have drawn from our assessment of the following?

- a) distributional modelling**
- b) the distributional impacts of the options**
- c) our wider system modelling**
- d) how we have interpreted the wider system modelling?**

Please be specific which assessment you agree/disagree with.

We have no firm views on this at this time.

11. Do you agree with our proposed approach to the reform of the remaining non-locational Embedded Benefits?

We accept the proposal to set the TGR to zero but would like to seek clarifications on how the generator cap will be maintained going forward. A gradual phasing to zero may therefore be appropriate to ensure that the issue is thoroughly considered.

We also welcome examination into embedded benefits that supports a level playing field between transmission connected generation and distribution connected generators. The transformation of the energy system needs to account for decentralised, distribution connected generation. The ability to treat generators as generators instead of negative demand will produce more a more transparent market with clearer pricing signals

Given the establishment of a BSUoS Task Force by the ESO, we feel there is a wider undertaking this year on examining issues with BSUoS that the TCR and its minded-to decisions need to account for. Issues such as the volatility and predictability of BSUoS present challenges to industry that the TCR may not address. However, activity in exploring if BSUoS can be separated into cost-recovery and cost-reflective components would be impacted by the outcomes of the TCR in decisions laid out on the treatment of residual charges. There are potential questions around whether a cost-recovery BSUoS would become a demand only charge, and how it could be charged fairly given the views set out within the TCR on volumetric charges in residual cost-recovery.

12. Do you agree with our proposal not to address any other remaining Embedded Benefits at this stage? Which of the embedded benefits do you think should be removed as outlined in xx? Please state your reasoning and provide evidence to support your answer.

Yes, the most significant embedded benefits are being examined within this SCR

13. Are there any reasons we have not included that mean that the remaining Embedded Benefits should be maintained?

As per our response in question 1, clarity on how the generation cap is to be maintained when the TGR is set to zero is required. A phase-out to zero, as opposed to a hard setting to zero from a given year may be better to prevent unintended consequences of what a future mechanism to maintain the cap could look like.

14. Do you agree with our proposed approach to transitional arrangements for reforms to:

a) transmission and distribution residual charges

b) non-locational Embedded Benefits?

Please provide evidence to indicate why different arrangements would be more appropriate.

We would like to point out the wide range of other reforms that are currently ongoing that may have interplay effects with arrangements under the TCR. As well as the AR SCR, work within the ESO-led BSUoS Task Force and the implementation of RIIO-2 are likely to make significant changes to the structure of network charges. We would therefore wish to see coordination and consideration of these other developments to ensure that investor confidence is maintained, and a coherent approach adopted. For example, as indicated in our response to question 11, the TCR and resulting definition of charges has the possibility to impact treatment of BSUoS charges.

15. Do you agree with our minded to decision set out? If not please state your reasoning and provide evidence to support your answer.

With regards to the implementation of a Fixed Charge or Agreed Capacity option, without understanding the outcome of the AR SCR, we are unable to determine whether the proposals represent a net benefit to the system, to consumers, and to network users who will require an increasing smart and flexible grid.

Again, we do not disagree with the principles that a residual charge be equitable and fair which the TCR will likely improve. However, we feel that issues concerning the loss of flexibility in the system and concerns on investors looking to provide these services have not been adequately addressed. Whilst the AR SCR will seek to address flexibility, this needed to be done in close cooperation with the TCR to produce a holistic review.

With regards to the minded-to decisions on embedded benefits, we are in broad agreement with the decisions, which we view as progressive towards creating a level-treatment of generators at all voltage levels. There are however broader impacts of TCR reform that may impact other reforms to BSUoS, which we have set out in question 11.

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16. For our preferred option do you think there are practical consideration or difficulties that we have not taken account of? Please provide evidence to support your answer.

As per our response to question 1 and 14, we would like to see practical consideration of the wider reforms that are currently ongoing and see solutions to how impacts such as the setting of the TGR to zero will have on EU838/2010.