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Targeted charging review: minded to decision and draft impact assessment
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Dear Andrew,

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

Uniper largely agrees with Ofgem's minded to position, but have some concerns about certain aspects. In summary:

1. We agree that residual charges should be recovered from demand users on a fixed charge basis. However, we have reservations about this being allocated to categories of user based on net demand rather than gross demand.
2. We support a review of Balancing Services Use of System (BSUoS) charging, but we believe the focus should be on getting the cost recovery right, thereby removing embedded benefits and cross border distortions in the current method, and not on trying to find targeted signals. We believe that this would best be achieved by charging demand only on a gross basis.
3. We understand the rationale for setting the Transmission Generation Residual (TGR) to zero. However, this unlikely to be practical while the €2.5 limit under EU Regulation 838/2010 is still in force. An alternative approach might be to change how locational charges are set, perhaps by adjustments to the reference node in the transport model.
4. When implementing changes, Ofgem should be consistent in its approach between the changes made under this review and other previous changes such as CMP264/5

Our responses to the individual questions posed in the consultation document are as follows:

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

Yes. It is important to carry on the work started with CMP264/5 to ensure that residual charges do not distort investment and operational decisions in the market. This will better promote competition in the provision of energy and balancing services, such as flexibility, ensuring that these are provided in the most efficient manner and reducing the cost to customers.

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.

Yes, the principles of reducing harmful distortions, fairness and proportionality seem appropriate. We believe that it is important that the distortions created in the market by the current treatment of network charge residuals and Balancing Services Use of System (BSUoS) charges are treated as a priority issue. The focus of the TCR appears to be mainly on the embedded aspect of these issues, considering discriminatory treatment between transmission and distribution connected resources. However, cross border distortions also need to be addressed and/or avoided and sufficient priority should be given to this issue too.

We believe that this means that residual and BSUoS charges should be levied on customer demand in a consistent manner and not on wholesale market participants such as generators and storage operators. This should of course be done in a fair and proportionate manner.

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?

This may be a sound assumption at present, but may also be worth challenging as the system becomes more active and multidirectional. Additionally, it should be borne in mind that competition in the retail market is very much facilitated by suppliers being able to access a country wide wholesale price and the liquidity this creates. It is also helped by customers being connected to the same integrated network, so that suppliers are truly able to compete effectively with each other and supply customers across the system. The wider integrated market will also support local trading of energy, as the access to an alternative wider market price puts competitive pressure on the prices that parties can demand through such a mechanism. This means that all customers at all voltages share similar benefits from being connected to the integrated network.

- 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.**

This seems a sensible approach.

- 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)?**

Yes. Both categories of customer equally benefit from access to the wider market, not only in terms of security and stability of their power supply, but also by having access to the wider market price, even if this is by providing a reference price against which a local solution can be negotiated and/or assessed.

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

Removing harmful distortions should provide benefits to customers through the creation of a more competitive market and driving better investment and operational decisions. This should mean more efficient (ie less costly) outcomes for customers in the provision of energy, low carbon generation, network investments and balancing services, including flexibility. The only think likely to prevent this from being realised would be the existence of a different market distortion, which clearly would then need to be removed.

We have heard arguments that addressing these distortions would undermine investor confidence and remove revenue from certain parties. Since privatisation the market has consistently been the subject of regulatory intervention when issues with the current arrangements have been encountered. We do not believe that any prudent operator would have assumed that this would not continue to be the case when entering the market. We do not believe that anything which has been proposed as part of this review is inconsistent with the principles of changes and reviews undertaken in the past. Indeed, not addressing the clear distortions that exist in this instance would undermine confidence in the regime, as it would represent a departure from the previous approach of dealing with these types of market or regulatory issue.

We are also aware of views that these changes will threaten targets for low carbon generation and/or undermine the provision of services such as flexibility. We do not believe that network charging arrangements should be used as an implicit subsidy for other purposes. A strong requirement for these other services clearly exists and should be facilitated by specific mechanisms designed to ensure their efficient procurement. This will mean that services and policy aims are provided by the most appropriate solutions in the best locations.

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

These seem to be practical solutions using existing processes and data sources.

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.

These seem sensible. The fixed approach seems to be better suited for smaller more standard sized customers, but there may be reasons why an agreed capacity based charge would be more appropriate for larger customers where there is a larger variation in size.

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?

This approach appears sensible.

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.

Yes, this seems to support our view that the removal of distortions should promote more effective and efficient competition which will benefit customers in several different ways.

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

We do support the aims of the reforms. However, we do not fully support the manner in which this is being tackled.

We believe that there is a significant issue to address with respect to the levying of BSUoS charges. The current methodology provides a significant embedded benefit and distorts cross border trade as power imported to the GB market is not subject to BSUoS. These imports cannot be charged due to EU regulations, so the only way to address this issue is to remove BSUoS from GB generation too. This latter distortion has been in existence since the implementation of the relevant modification to the charging rules, CMP202, in 2012. We therefore believe that this is the priority issue to address, with respect to BSUoS, as this not only provides incorrect dispatch decisions, but is also likely to affect investment decisions, resulting in too high a level of

interconnection and too low a level of GB based capacity being maintained on the network.

If embedded and behind the meter generation is to be treated in a consistent manner, then it too should not be exposed to BSUoS charges, either as a charge or as an embedded benefit. Therefore, it should be charged to demand alone and on a gross basis, not net of embedded or onsite demand.

We do not agree that this should only be considered after the BSUoS task force has carried out its work on assessing whether some cost elements could be charged in a targeted way to provide a market signal. A considerable amount of analysis of BSUoS and the elements which go into it has already been undertaken, and it is not apparent that such signals exist. If they do, then this must be within a minority of costs, as the remaining cost is currently of such a magnitude that it is preventing them from becoming apparent. Therefore, it is safe to assume that there will be a significant proportion of BSUoS costs which will continue to be recovered on an untargeted basis, presumably along the principles outlined for the residual charges.

We believe that work should start now on how that cost recovery is to be achieved going forwards. It does not need to wait for the output from the BSUoS task force in May, or perhaps later, as is presently proposed. We are concerned that this will waste valuable time in addressing the key distortion that exists with respect to BSUoS. To this end, we are supportive of work being undertaken as part of CMP308, which is aiming to address the distortion to cross border trade.

On the Transmission Generation Residual, we believe that retaining a negative, or indeed positive, residual charge results in differential treatment between transmission and distribution connected generation and that this should be addressed. However, there is a real difficulty associated with simply removing the generation residual whilst the €2.5/MWh limit on generation charging still exists under EU Regulation 838/2010.

This could be addressed by setting locational charges at such a level that the EU limit is not breached, perhaps through an adjustment to the reference node as proposed under CMP284, or through a simple adjustment by adding or subtracting a constant to the locational tariffs generated using the existing distributed reference node. Either approach should result in the same level of charge. The aim of this should be to ensure that the regulation is met, as well as creating locational signals for generation and demand users which are consistent. We note that the matter of the reference node has been identified as a non priority issue to be considered as part of the Network Access and Forward Looking Charging Review. However, we believe that this work could be brought forwards as part of the work to address the TGR issue.

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.

This seems reasonable given the relative sizes of the other embedded benefits.

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

No. Distortions should be removed and should not be used as a proxy for addressing any other market issues which may exist. These should be identified and solved separately.

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 believe that all distortions should be addressed as soon as possible. We note that the TGR is being classified as a non-locational Embedded Benefit (category b. above) and therefore possibly would be subject to a different implementation approach to that adopted for demand transmission and distribution residual charges (category a. above). We would question whether this should be the case as all proposals are addressing an issue with network residual charging and so potentially could be implemented in a consistent manner.

We understand the argument for looking at implementing the TGR proposal sooner, as this proposal is seeking to ensure that there is consistent charging between embedded generators affected by CMP264/5 and transmission connected generators. However, the CMP264/5 change was implemented with a three year phasing in period, so there is an argument to use the same approach for the TGR change too in order to ensure consistent treatment.

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

Yes largely. In terms of principles, we agree that residual charges should be recovered in such a manner that they do not distort the forward looking signals provided elsewhere in the methodologies. We are less convinced about the need to avoid redistributions of revenues. We understand why Ofgem might wish to minimise change to the relative amount of charges that different customer groups pay within the overall category of demand users. However, by definition, changing the methodology to address a significant distortion in cost allocation will, and should, create redistributions between different categories of users in order to have the desired effect.

We are generally supportive of the minded to decision on residual charging. We believe that the proposal to allocate costs to categories of user according to net demand seems contradictory to the approach of removing embedded benefits, but can understand this being adopted for purposes of simplicity.

For BSUoS, our favoured approach would be to charge demand BSUoS on a gross basis and to not charge generators. This would remove both the embedded benefit and the distortion to cross border trade caused by the current methodology. If this was not likely to occur for a while, then we would support the interim proposal to charge



demand BSUoS on a gross basis and charge embedded generation too. Of course, this would mean the cross border distortion would remain which we still see as a significant issue.

Addressing the BSUoS charge in a similar manner to residual charging is a good idea in principle. We would question whether the same approach could be adopted in practice. TNUoS and DUoS charges are set for relatively fixed levels of cost, largely known ahead of time and recovered over an annual period. BSUoS costs accrue on a half hourly basis and are highly unpredictable. A different approach will be necessary, unless the ESO were to take on the role of managing the risk by setting fixed charges for a period ahead of time, as proposed under CMP250. We would be supportive of this approach.

As we mention in our response to question 11, we understand the desire to set the generation residual tariff to zero, but there are real practical issues to address in order to ensure that there is no breach of EU regulation 838/2010.

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.

No. We believe that we have covered any such issues in our answers to other question above.

I hope that the above answers prove helpful. I would be happy to answer any further questions you may have.

Yours sincerely,

Paul Jones
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Uniper UK Limited