

Ofgem Forward Work Programme 2021/22 consultation

Consultation response by members of the Independent Renewable Energy Generators Group (IREGG)

19 February 2021

Executive Summary

- Members of IREGG (the Independent Renewable Energy Generators Group) are concerned that regulatory plans developed by Ofgem in a pre-net-zero context (such as the Targeted Charging Review) appear to be proceeding without independent and transparent assessment of whether or not they support or detract from the UK Government's net-zero ambitions.
- IREGG members predominately focus on the development of onshore wind, much of which is constructed in the areas of Great Britain a) where it is windy and b) where planning and policy environments allow wind farms to be built.
- IREGG is concerned that Ofgem's regulatory plans and locational charging proposals, which will penalise the development of renewable generation in the areas of Great Britain where they can generate and be most cost-effective, will increase the overall costs that the UK must pay to achieve its net-zero ambitions. At worst, they could render the UK's Net Zero goals impossible to achieve at all.
- IREGG is concerned that Ofgem's regulatory plans are detrimental to investor confidence and would hinder the UK's ability to compete in the European marketplace. IREGG would like Ofgem to pause its implementation of its regulatory plans to assess whether they accord with the new net-zero environment in which the UK finds itself.
- IREGG, as a result, is clear that such considerations need to be addressed by Ofgem when analysing the content of its Forward Work Programme.

Introduction

IREGG (the Independent Renewable Energy Generators Group) was established in 2012 and is a partnership of independent renewable energy generators and developers, as well as the manufacturer Enercon. Its members have invested hundreds of millions of pounds in UK energy infrastructure.

IREGG members include:

- **Falck Renewables:** a renewable energy company based in Milan, Italy which produces energy from wind, solar, biomass and waste-to-energy sources.
- **Banks:** a County Durham-headquartered renewables business operating and developing wind and solar projects.
- **BayWa:** a German headquartered solar, wind, and bioenergy company, developing, constructing and operating renewable energy projects across the UK.
- **ERG:** an Italian producer of wind, solar, hydroelectric and thermoelectric energy.
- **Infinergy:** an energy company developing large, medium and small-scale onshore wind and solar PV projects in the UK, the Netherlands and Australia.
- **Enercon:** a Germany-based wind turbine manufacturer and one of the world's leading companies in the wind energy industry.

Onshore wind remains the best-value renewable energy technology and bringing enough projects to market is vital to meeting the UK's national green energy targets – specifically the more ambitious 2050 net-zero target.

While onshore wind will have access to the next Contracts for Difference (CfD) allocation round, there remain challenges and barriers to connecting sufficient levels of renewables to the grid to achieve net-zero.

2021 brings a real opportunity to expand the acceleration of onshore wind deployment in the UK, especially in Scotland.

In our response we seek to engage constructively with Ofgem's proposed work programme and Ofgem's overall strategic objectives. We outlining some of the clear and present risks which could have a significant negative commercial impact on developers and generators in onshore wind as well as the Government's policy environment to achieve net-zero – an environment in which Ofgem should operate and play a constructive role.

Response

Foreword

We welcome your CEO's reference in his Foreword to "our commitment to supporting this country's transition to net-zero", a commitment which we wholeheartedly share.

As long-term green energy investors in the UK, we are acutely aware of the scale of the challenge – and the need, as the Committee on Climate Change (CCC) has underlined – to accelerate the scale and rate of green energy deployment over the coming decades as compared to the previous ten years. We acknowledge that a "steady state" rate of decarbonisation will be insufficient.

Ofgem's work programme obviously covers a wide sweep, and some of its plans have by necessity, involved a gestation period of several years. In some cases this might not matter, but where the external context has radically evolved a re-evaluation may be necessary.

Where many years have passed between the date on which Ofgem embarked on developing proposals for regulatory reform and the planned date of implementation, it is important – for both predicting the impact of regulatory changes and for investor confidence – that there is seen to be a process by which the plans can be assessed against their compatibility with the new external benchmark.

Given the significance of the UK's net-zero commitment, the degree of its impact, and the stated commitment of Ofgem's CEO to supporting that goal, it seems ill-considered that significant Ofgem regulatory plans that were conceived and developed in alignment with a pre-net-zero policy context (such as the Targeted Charging Review (TCR) which was launched in 2017), appear to be proceeding without independent and transparent assessment of whether or not they support or detract from that goal.

The suite of Significant Code Reviews (SCR) involving the TCR, Forward Access Review and others were conceived, developed and planned in a pre-net-zero age and are proceeding without an updated goal being sufficiently factored in.

The engagement that independent energy generators have had with Ofgem during that process has underlined the absence of any salient adjustment to proposed changes to regulation.

We have been told in our engagement with Ofgem that as the independent regulator there is an expectation on its part that it may progress its plans to alter network charging in the knowledge that their negative impact on legally binding net-zero obligations will need to be offset by the government. We would appeal to Ofgem not to rely on government to offset the negative impact via the CfD mechanism only but instead re-evaluate its changes in light of the net-zero target.

In his foreword to this Consultation, your Chief Executive Jonathan Brearley stated that one of Ofgem's primary objectives will be to "enable investment in the low carbon infrastructure needed to deliver net-zero."

In the context of this clearly stated position, independent energy generators are keen to clarify the following outstanding points and questions for our investors.

1. Investors are competing in a global market for low-cost finance. If the rate of return for GB energy generation is insufficient to meet the hurdle rate for those investors, generation will not be built or repowered.
2. Ofgem's plans propose to increase the scope and scale of costs that generators would be required to pay for GB energy networks (costs which are already beyond what generators pay in many competing overseas energy markets such as Germany).
3. As such, when will an independent assessment be published which stress-tests the risk that Ofgem's plan could undermine the rate of return of GB generation relative to competing foreign generation, and lead to necessary GB investment being diverted to overseas low carbon energy generation or alternative competing asset classes with greater rates of return for equivalent commercial risk?

Point 1: Ofgem's new strategic framework

4. Under Point 1 of the Consultation, Ofgem states that a key objective is "decarbonising to deliver a net-zero economy at the lowest cost". Elsewhere, it states the first of the three components of its Objective as being "working with government, industry and consumer groups to deliver a net-zero economy, at the lowest cost to consumers".
5. Ofgem further states that "delivering on our vision will require Ofgem to take a leadership role in the transformation of the energy sector, establishing itself as a world leader in regulating for decarbonisation, making effective use of data, and taking a whole system approach to deliver net-zero at the lowest cost."
6. The consultation later states a key aim to be: "Efficiently transforming the onshore electricity network, connecting new sources of supply... to meet net-zero targets".
7. It is well understood that the overall cost to the consumer of the transition to net-zero in 2050 will be the sum of three things:
 - a) The costs of new low and zero carbon capacity to ensure there is sufficient zero carbon generation;

- b) The costs of upgrading and adapting the pre-existing energy networks, designed as they were for a pre-net-zero generation system, to the new types of generation needed and the new locations they require;
- c) The costs of consumer adaption, including for example replacements for gas boilers in homes and businesses, whether that be electric heat pumps, hydrogen boilers or alternatives.

Given that Ofgem's plans to minimise the extra costs of (b) involve raising the costs of (a), with the highest increases being levied in specific areas, rather than making more uniform the already sloped playing field, what independent assessment will there be to stress test Ofgem's plans against the risk that they will increase the overall cost of net-zero for the consumer, by adding extra costs to (a) that will outweigh the avoided costs of (b)?

- 8. Given the importance that the CEO of Ofgem has given to Ofgem's support of the UK's net-zero goals, it is surprising that the new strategic framework does not reference this, in either its two enduring priorities, or its five strategic change programmes.
- 9. We would suggest that Point 1 of the five strategic change programmes, with the current wording "to enable investment in low carbon infrastructure at a fair price", might be more clearly aligned to the government's net-zero ambitions if it were updated as such: "To enable investment in *sufficient* low carbon infrastructure *within the optimal timeframe to secure net-zero* at a fair price". We would also welcome the consideration of clear instructions that link 'fair' to wider environmental metrics.

Point 4: Low carbon infrastructure

- 10. Under Point 4, the consultation states that Ofgem aims to "maximise the opportunities to enable a smart, lower-cost zero-carbon future [...] by: Taking a coordinated approach to the expansion of the offshore network and interconnectors" and to "Create a framework for a coordinated expansion of offshore networks to enable increased generation and transmission".
- 11. In that context, why is Ofgem seeking to penalise zero-carbon offshore generation with extra charging costs when it is not planning to impose these charges on generation imported from EU countries on the continent? And how does making Scottish green power more expensive compared to EU continental imported power reflect the Brexit mandate?
- 12. In Ofgem's low carbon infrastructure strategic change programme the goal of "connecting new sources of supply and increasing demand to meet net-zero targets" needs to clarify whether interconnectors are considered as 'supply' and whether all sources of 'supply' can benefit from a level-playing field.
- 13. At present, Ofgem's approach is creating a distortion in competitiveness which runs counter to its stated aim of removing distortions between transmission-connected and distribution-connected generation. Point 4 lacks detail on the need to strategically develop the network to account for the increased use of the renewable sources of electricity which provide the cheapest sources of zero-carbon energy.
- 14. As price controls are now in place to take account of net-zero related expenditure, they demand a high level of certainty around project progression. The charging reforms, however, have created large amounts of investment uncertainty as they do not take

into account the inability of developers to construct renewable generation projects away from their fuel source, e.g. where it is windy.

15. Therefore, although the mechanisms to finance net-zero expansion are in place, the lack of a strategic approach towards creating a level playing field for net-zero technologies (which also relates to interconnector charging) combined with a lack of forward-looking certainty means that the net-zero reopener could be underutilised as a result.
16. Ofgem will need to provide frameworks not only to help manage regulatory reform uncertainty, but also to take account of the net-zero development goals of the UK and how their strategic network development could impact the deployment of the most cost-effective zero-carbon generation.

Point 5: Full chain flexibility

17. Point 5 of the consultation states that Ofgem plans to “develop and implement electricity network charging reforms to promote efficiency and flexibility”, yet Ofgem’s network charging proposals need to illustrate how they would increase efficiency.
18. Central to the premise of Ofgem’s proposals seems to be the presumption that minimising the investment required to adapt the electricity networks to meet the requirements of net-zero, will of itself guarantee that the transition to net-zero is most “efficient” and cost effective for consumers.
19. Ofgem’s proposed changes, which aim to utilise locational charging penalties to minimise the investment needed to adapt the electricity network, impact the signals that renewable energy policymakers want to send to the market. Moreover, the superior ability of fossil fuel generation to react to locational charging signals as compared to renewable generation whose location needs to align with optimal wind, wave, or sun, means that the proposed changes would perversely incentivise the development of large new fossil fuel power stations over renewables.
20. Ofgem has acknowledged to IREGG in meetings that efficient zero carbon generation requires access to the best resource: wind farms to be built where it’s windy, solar generation to be located where it is sunny, and hydropower to be developed where it is sufficiently wet in order to secure efficient generation.
21. “Locational charging” as a concept thus becomes less purposeful for technologies which are limited in their choice of location not only by the availability of natural resource, but also by the expressed interest of the UK government’s planning policy since 2015.
22. Even if wind generators were free to locate close to major demand centres in the south of England, they would simply generate less power, less reliably, and less frequently, than those in windier locations in Scotland.
23. Imposing this regime on GB wind power would therefore hypothetically require greater numbers of non-optimally located wind farms in places where there is weak or absent policy to support generation development. Far greater capital investment would be needed to secure a given amount of power as a result.

24. There would be additional risks: that assets are less efficient or that projects would fail to clear their hurdle rate, leading to investment going to competing countries which do not impose such charging penalties.
25. The Prime Minister recently stated: "As Saudi Arabia is to oil, the UK is to wind - a place of almost limitless resource, but in the case of wind without the carbon emissions and without the damage to the environment. We've got huge, huge gusts of wind going around the north of our country - Scotland. Quite extraordinary potential we have for wind."
26. The Scottish Government has a strong track record in renewable generation development and a supportive planning system.
27. Counter to this, Ofgem's network charging proposals will impose extra charges on zero carbon generation in Scotland and other places in "the north of our country". This will undermine the economics of such projects relative to EU imports via the continental interconnectors and will therefore have a negative impact on the GB renewable energy sector.
28. Ofgem's planned measures have yet to be adapted to take account of the UK Government's future plans regarding the development of renewables. How will Ofgem's Forward Work Programme ensure that the regulator acts in a way that will support the Prime Minister's stated ambition?
29. Ofgem has not addressed the tension that resides between its locational charging proposals, developed in a pre-net-zero era, and the locational aspect of the UK planning system. Such tension, and a lack of support on Ofgem's part for the realisation of UK Government policies, could undermine investor confidence. How does Ofgem plan to resolve this tension?
30. In the absence of an independent holistic impact assessment developed by modelling the combined TCR decisions, Access SCR proposals, and Connection and Use of System Code (CUSC) modifications that impact use of system charging, it is not clear why the Forward Work Programme - particularly in areas of setting net-zero framework and strategy - is not based on independent and transparent analysis of how charging reform could impact lowest cost renewable generation.
31. The uncoordinated manner in which Ofgem has approached transmission charging reform has led to perverse inconsistencies in Ofgem's reasoning between the two code reforms, the result of which is to further increase costs on new and existing renewable energy generators. For instance, a key rationale in the TCR for removing the Transmission Generator Residual was that it was a distortion that only Transmission Network Use of System (TNUoS)-liable generation could receive this, but having acted to remove the TGR, and therefore increase TNUoS costs for all generation, Ofgem is now proposing via the AFLCR that DSG should also pay TNUoS.
32. We support points made in a recent SSE report which urge that a review of TNUoS should take place in a manner at least as significant to that which took place under Project Transmit in the early 2010s. This review recommended the adjustment of tariffs to reflect differences between wind farms and other renewables which had lower load factors than conventional generators. Without a similar review to solve the inherent conflict between the Government's ambition to grow the scale and rate of deployment of UK renewable energy generation and the TNUoS signals that disincentivise developers from adhering to this direction, the UK's net-zero commitment will be

undermined. The volatility in TNUoS reflects a weakness in the overall model and questions the accuracy of the signals that are given to generators.

33. When we have discussed our concerns regarding charging reform with Ofgem, we have been told that Ofgem accepts that its proposals would indeed adversely impact net-zero should the Government not take action to implement and raise the CfD pricing to offset the extra costs that Ofgem reforms will impose on new and existing UK zero carbon energy in Scotland.
34. Will Ofgem pause implementation of its plans to allow an independent and transparent assessment of how its ambitions for accentuated locational network penalties could impact the UK's net-zero ambition and increase the burden on billpayers by requiring offset funding to ensure that generation is viable?

Point 11: Estimated expenditure

35. Ofgem has stated its commitment under Point 11 in the consultation and in its Comprehensive Spending Review bid to HM Treasury in September 2020 "to support the net-zero ambitions of the UK and devolved administration governments, to facilitate investment and innovation and to reduce the cost of energy".
36. The Scottish Government, however, has raised concerns that Ofgem's ambition to impose penal locational charging on Scottish power generation will detract from, rather than support, its net-zero ambitions. As investors in Scotland, we would be grateful if Ofgem could ask the CCC to independently assess the adjustments to its agenda that it needs to make to ensure that the concerns raised by the Scottish Government are addressed and its ambitions supported.
37. This is particularly important in light of Scotland's target to reduce CO2 emissions by 75% from 1990 levels by 2030 which is a very short timeframe compared to the Westminster net-zero target of 2050. To achieve this, higher levels of onshore wind will be needed - as much of the ScotWind offshore generation for example has longer lead times. As a result, any reform that puts Scottish generation at a competitive disadvantage to English generation in the CfD auction puts this target at risk and counteracts any stated benefit other renewable projects in England could reap based on their 'better' location.

We would be delighted to submit further information should there be any questions arising from our submission.

IREGG CEOs

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