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Dear Keith,

DRAFT FORWARD WORK PROGRAMME FY 2016-17

Thank you for the opportunity to comment on Ofgem's work and priorities as set out in this consultation.

The programme appears to reflect the key duties and responsibilities for Ofgem and Ofgem E-Serve over the coming year. We agree with Ofgem's prudent approach to this year's work plan, recognising the likelihood that there will be impacts from the final conclusions of the CMA market investigation, and the probable need to review the plan in light of them.

We agree that the move to principles based regulation has the potential to improve consumer outcomes and help facilitate innovation in the market. We agree with the sentiment that the transition to this new approach will require quite a lot of work over the next few years and stand ready to play our part. It will be helpful for industry and the regulator to develop an approach to compliance which both delivers for consumers, and recognises the inherently lesser precision of a principles-based approach.

We also welcome Ofgem's continuing focus for the coming year on cost-effectively maintaining security of supply. In this context, we would highlight the importance of ensuring of that there is a level playing field for all types of generation, including large-scale gas-fired power stations, in delivering security of supply cost-effectively.

Whilst we believe that the market-wide capacity mechanism (CM) is fundamentally the right mechanism for promoting investment and maintaining security of supply, we consider that there is one key area where Ofgem and the Government should take steps to promote a more level playing field. Specifically, steps are needed to prevent embedded generation from being rewarded twice for capacity through the CM and the network charging regime (the so-called "triad benefits"). At the moment, in 2019/20, we estimate that small embedded generators could get £45/kW on top of the CM payment of £18/kW from the CM, while larger power stations would get just the £18. This over-reward risks the proliferation of diesel and similar units beyond the level that would be economic.

We believe the most expedient way to rectify this distortion is to modify NGET's charging methodology to prevent generators in receipt of CM payments also receiving Triad benefit. Such a change could either deliver the solution directly or work with changes to the CM rules or Regulations. It is important that such changes have effect from the 2016 CM auction and that the outcome is clear sufficiently early this year to provide bidders with a firm basis for participating in the next CM auction round. While there are a number of variants on the precise approach for remedying this problem, it is clear that Ofgem will need to devote resource in 2016 to both:

- (a) considering – within the context of its ongoing review of the CM rules – what changes might be needed in the overarching legislative and regulatory framework for the CM so as to address this over-reward issue in a timely way; and
- (b) ensuring that the necessary Code changes are swiftly decided upon.

Finally, we would mention the continuing distortion that occurs in relation to interconnectors, where a CCGT built on the continent may gain from tax and charging methodology arbitrage worth about £11/MWh compared to a similar new station in Great Britain. It is important that this distortion is ironed out as quickly as possible. While much of this distortion is the result of the Carbon Price Support tax, a significant part is in Ofgem's gift and relates to the incidence of various grid charges which are charged on consumers on the Continent, but partly on generators in the UK. It would be helpful if Ofgem could devote resource to considering how the elements of that distortion that fall within its responsibility can be swiftly phased out.

I hope you find these comments helpful; if you have further questions about this response, please don't hesitate to contact me.

Yours sincerely,



Rupert Steele
Director of Regulation