

Judith Ross
Energy Systems Integration
Ofgem
9 Millbank,
London
SW1P 3GE

3rd May 2017.

Dear Judith

Consultation on Ofgem's Targeted Charging Review ("TCR").

Green Highland Renewables ("GHR") welcomes the opportunity to comment on this consultation. GHR is a company focused exclusively on developing, building, operating and maintaining hydro-electric schemes. Established in 2007, we are a major player in the UK small-scale hydro sector successfully constructing 42 projects and securing planning consent for over 62 hydro schemes with around 50MW capacity.

GHR agrees that the current arrangements were designed for a system with passive demand and large scale generation. We don't believe the current 3 winter peak demands being used to signal charges is fit for purpose. We recognise the issues that have been raised with Ofgem recently and we'd agree that a Significant Code Review is called for.

However, we believe the scope of the review detailed in the consultation isn't broad enough. We've structured our response to answer the 22 questions asked in the consultation. As an owner and operator of small scale generator, we'd highlight the following key points;

- **The scope of the review isn't broad enough; any review of charging arrangements must acknowledge the longstanding, complex and significant differences between transmission and distribution connections;**
- **We believe the review needs to consider the quantum of the residual element;**
- **We'd highlight that other countries appear to have taken a broader look at the charging regime first, before focusing on the mechanics of the residual element;**
- **The proposed principle of fairness will be near to impossible to define given the almost unlimited potential views on what is fair and what is not, and hence we believe that Ofgem should focus on what is manifestly unfair;**
- **Small scale Feed-In Tariff generators don't access the market in the way described and as such we don't distort the market;**
- **Feed-In Tariff support regimes were designed with consideration to construction costs and ongoing operational costs that were known at the time. Investment decisions were made on that basis;**

- Hence, although the current system cannot be considered fit for purpose, it was fundamental to the understanding of the cost basis at the time when long term investment decisions were made, and hence, significant changes will fundamentally change the financial assumptions that underpin the support mechanism and this will undermine Government policy;
- We are concerned that Ofgem are focusing solely on embedded benefits in considering market distortions, whilst ignoring other network charges, such as connection charges;
- Distortion can only be established if all costs faced by the different class of generators are considered;
- By their very nature, small-scale run-of river hydro schemes produce energy when weather conditions dictate, hence any negative financial impact from tariff changes cannot be mitigated against;
- Hence we advocate that grandfather rights are appropriate.

In conclusion, we believe that the scope of the consultation is too narrow and does not consider the big-ticket items. The scope outlined in this consultation does not merit a Significant Code Review. However, we'd encourage Ofgem to adopt a broader and more holistic approach to avoid any further unintended consequences and market distortions.

We'd welcome the opportunity to discuss these points further.

Yours sincerely,



Mark Mathieson

CEO

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?

Answer 1: GHR believes that the current arrangements were designed for a system with passive demand and large scale generation. The energy system is changing and hence we are supportive of a Significant Code Review. We'd highlight the following key points;

- We don't believe the current 3 winter peak demands being used to signal charges is fit for purpose. Network users are likely to be responding where they can to retail price signals during this period and impacting on the quantum of charges and who they fall on. Hence, a system based on peak demand is likely to have unintended consequences.
- The change in our energy system has been and will continue to be significant, and hence as such, Ofgem needs to exercise great caution in determining this review to ensure that we have a charging system that is reflective of the way users *will* interact with the energy systems. Reducing peak demand to create capacity for the electrification of heat and transport is important to keep network costs down for consumers, so care needs to be exercised that any future charging regime doesn't impede this.
- The transition will need to protect the interests of those who have made investments under the current regime.

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

Answer 2: Although the current system isn't fit for purpose, it is the basis that investors made decisions to invest in the energy system. Hence, although not fit for purpose, it was known and understood and hence if action is proposed, in-depth Impact Assessments are required.

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.

Answer 3: We understand the issues that have been raised with Ofgem on the appropriateness of the current charging regime and believe that a Significant Code Review (SCR) would be appropriate. However, we are concerned that the scope of work that Ofgem has identified does not deal adequately with these issues, and indeed the areas of work Ofgem have identified would not require a SCR to consider changes. We'd encourage Ofgem to also consider;

- Network access arrangements for both transmission and distribution networks
- The appropriateness of the quantum of the residual charging element

Failure to do so could risk further unintended consequences, market distortion and the ongoing viability of projects that have been invested in.

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

Answer 4: We agree that there are elements of the approaches in other countries that could be appropriate. Equally, the learning from these approaches, impacts and unintended consequences from these jurisdictions should be used to inform any decision. We'd highlight that other countries appear to have taken a broader look at the charging regime first, before focusing on the mechanics of the residual element.

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| Question 5: Are there other approaches that you know about from other jurisdictions, that you think offer relevant lessons for GB? |
| Answer 5: As per our answer to question4, we'd encourage Ofgem to consider a broader approach to this review. |
| 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. |
| <p>Answer 6: Ofgem have 3 proposed principles;</p> <ul style="list-style-type: none"> • Reducing distortions • Fairness • Proportionality and practical considerations <p>We'd make the following key points.</p> <ul style="list-style-type: none"> • In considering distortions, robust analysis is required. We have a concern that the analysis will be over simplistic as seen in the "minded to decision" on embedded benefits for small generators, where the analysis didn't take account of network connection charging differences. The "minded to decision" if implemented, will have a significant financial impact on small scale generation that doesn't access the Capacity Market and hence doesn't distort the market. • In terms of fairness, whilst we can understand the sentiment, we believe that Ofgem will struggle to define this. For example, some may argue that it is manifestly unfair that the residual is recovering revenue for network companies whose achieved returns are far greater than what is achieved in the rest of the market. Hence, we believe it is important that Ofgem deals with issues that are manifestly unfair, rather than trying to define what fair looks like. • We believe that one of the considerations must be the changes in impact on users of the network and their ability to respond to the changes. For example, GHR as a small-scale hydro generator made investment decisions based on the economic circumstances at the time. These investment decisions are based on decades of future operation, and hence any change in network charging costs may have a significant impact that cannot be remedied. Consideration must be given to grandfather rights as opposed to transitional arrangements. |
| 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? |
| <p>Answer 7: We believe that the proposed review has an insufficient scope and hence comment on these specifics is inappropriate. However, we believe that whilst there will be pressure from different sectors as to who should pay/not pay, Ofgem must take into consideration that small-scale Feed-in Tariff generation is supported by Government policy. The support mechanism has been set to make projects financially viable and is based on a bottom up evidence base of the known cost at the time. If Ofgem conclude that small-scale renewable generation should be exposed to additional charges, it will have fundamentally changed the financial assumptions that underpin the support mechanism and this will undermine Government policy. Hence, we urge Ofgem to not change the charges that small scale embedded generation is exposed to.</p> |

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| 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? |
| Answer 8: As per answer 7. |
| Question 9: Do you support any of the five options we have set out for residual charges below, and why? |
| Answer 9: We believe that a broader review is required. |
| Question 10: Are there other options for residual charges that you think we should consider, and why? |
| Answer 10: We believe that a broader review is required. |
| Question 11: Are there any options that you think we should rule out now? Please say why. |
| Answer 11: We believe that a broader review is required. |
| 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’)? |
| Answer 12: We’d highlight that whilst the charges may be considered not fit for purpose, and we believe that this proposed review has insufficient scope; Government has chosen to support small scale embedded generation through the Feed-in Tariff regime. FIT rates have been designed from a bottom up, evidenced cost basis, to determine the support required to make these projects financially viable. Hence, if Ofgem changes the charging regime for small-scale FIT generators, it is fundamentally undermining financial viability of projects that form part of Government policy. |
| Question 13: Do you think changes are needed to the current charging arrangements for smaller EG, and when should any such changes be implemented? |
| Answer 13: We are concerned that all embedded generation is considered as behaving and reacting to the market identically. The reality of the situation is that Feed-in Tariff small scale hydro, wind and solarPV don’t access the market in the way described. Decisions on when to and when not to generate do not apply as output is dictated by weather conditions alone. Hence, markets aren’t being distorted. Support mechanisms for these schemes were calculated to reflect the construction and ongoing operational costs at the time, and hence negative impacts from changes to the charging regime will impact the financial viability of these schemes, which due to their very nature, have no way to mitigate changes. In conclusion, where there is no market distortion, and the imperfect charging regime has been used to determine the level support required to make projects financially viable, Ofgem shouldn’t be proposing changes that undermines Government policy. |

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| Question 14: Of the embedded benefits listed in our table, do you think that any should be a higher or lower priority? |
| Answer 14: We don't believe that Ofgem is considering all network costs faced by the different generation categories in its analysis, nor is it recognising that within the subset of embedded generators, there are those generators who by their very nature, do not and more fundamentally cannot distort the market. |
| 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? |
| Answer 15: Connection charging methodologies differ between Transmission and Distribution and hence need to be factored into any analysis on advantages/disadvantages. |
| Question 16: Do you agree with our view that storage should not pay the current demand residual charge, at either transmission or distribution level? |
| Answer 16: We disagree with the statement at 8.4 that storage largely competes with generators. This is an oversimplification of role of storage in the wider energy system. There are alternative forms of storage on the energy system and hence any proposals need to be considered in terms of market distortion with alternative forms of storage. Hence, we believe that Ofgem is in danger of "picking winners" with its approach and believe that the issue needs to be dealt with as part of a wide-ranging review and not the quick fix that has been suggested in the consultation. |
| Question 17: Do you agree with our view that storage should not pay BSUoS on both demand and generation? |
| Answer 17: As above in answer 16. |
| Question 18: Which of the BSUoS approaches describe is more likely to achieve a level playing field for storage? |
| Answer 18: As above in answer 16. |
| 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? |
| Answer 19: As charges are designed to recover a fixed income from several different sectors, GHR believes that all changes and impacts need to be considered together to ensure consistency and fairness across all sectors. Hence our support for a broader review. |
| 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. |
| Answer 20: We welcome the establishment of the CCG. We believe it should include representation from all stakeholders, including operators of small scale embedded generators. |

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| Question 21: Do you agree with our proposed delivery model, including its scope? |
| Answer 21: We believe Ofgem need to revisit the scope of the review first. |
| 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? |
| Answer 22: As stated before, we believe that the review needs to have a broader scope. |