



3rd Floor North
200 Aldersgate Street
London EC1A 4HD
Tel: 03000 231 231
stew.horne@citizensadvice.org.uk

Andrew Self
Ofgem
9 Millbank
London SW1P 3GE

11 April 2017

Dear Andrew,

Consultation on CMP264 and CMP265 minded to decision

Thank you for the opportunity to respond to your consultation on CMP264 and CMP265 minded to decision. Citizens Advice has a statutory duty to represent the interests of energy consumers in Great Britain. This submission is non-confidential and may be published on your website.

Overall, we support Ofgem's aim to remove the distortion which is currently provided by embedded benefits to sub 100MW generators, and we are pleased that Ofgem has looked to take swift action in the area to protect consumers. We believe it is likely that the current arrangements are causing significant consumer detriment. It is an important part of Ofgem's duty to consumers to make sure that issues surrounding embedded generation are addressed.

Overall, we think that some level of triad benefit is appropriate for embedded generation, because it encourages an efficient reduction in investment in locationally more expensive parts of the transmission network. In our view, it is therefore sensible that all embedded generators can avoid the locational TNUoS charge, as a way of meeting this objective. We also agree that avoidance of the demand residual charge, which funds the existing operation and sunk costs of the transmission network, is the principal potential distortion that needs to be considered.

In our view there are two additional factors in which we would encourage Ofgem to take into account in making their decision:

- a) **Regulatory uncertainty.** WACM 4 goes some way beyond the intended effect of the original CMP264/265 proposals. Ofgem is proposing to remove a significant proportion of revenue streams for embedded generators over a relatively short period of time. We think that this is the removal of a distortion, and agree investors should bear the risk. Sound investors should be aware of revenues that are derived from market distortions such as this. But there is a risk that this could result in increased regulatory uncertainty, and therefore this could result in higher costs for consumers. Extending the phasing period beyond the period proposed for WACM4 for the removal of the benefit may reduce this risk.

- b) **Closed/unbuilt plants.** In our view it is possible that some plants could close or not get built under the intended position as a result of the embedded benefit that is removed. There are some embedded generators in the 14/15 capacity mechanism, and may close or not be built despite the exit costs. Any capacity shortfall would need to be made up from subsequent capacity auctions. Ofgem should consider what impact the offsetting of capacity demands from one auction to another may have on consumer costs.

Setting an interim level of TDR benefit

We see merit in the logic of centering costs around the cost of Grid Supply Point reinforcement as proposed by WACM4, and this may be where a long term solution lies. But we think that adopting WACM4 or any other solution ought to be an interim step. This would be appropriate to protect consumers interests whilst Ofgem carries out its wider Targeted Charging Review (TCR). In making this interim decision we would encourage Ofgem to consider which WACM best meets the CUSC objectives and also minimises any potential additional costs to consumers.

Establishing long term level of embedded benefit

We feel an interim solution is appropriate because of the way that embedded benefits are part of the wider picture of charging design. On a wider basis we think a long term decision on embedded benefits should be taken through the TCR. It is uncertain whether the current charging methodologies are fit-for-purpose in a changing technological landscape.

As and if the energy system changes to a more distribution-led, demand-responsive order it may be appropriate to provide stronger price signals

to accommodate this. Reform taken under the energy system's current technological profile could need to be undone quickly as the technological profile shifts. We think it would be a mistake to only consider the embedded benefit that emerges within the current charging design without reflecting on whether the design of these charging methodologies are themselves appropriate.

We would be very happy to discuss this response with you.

Kind regards,

Stew Horne
Principal Policy Manager, Energy Regulation

Question 1: Do you agree with our problem definition and that the Transmission Network Use of System (TNUoS) Demand Residual (TDR) payments to sub-100MW Embedded Generation ("smaller EG") are distorting dispatch, wholesale price, the capacity market (CM) and that they pose an increased cost to consumers?

We agree with Ofgem's problem definition. We see two principal consumer impacts. Firstly, if the TNUoS charging methodology is encouraging economically inefficient investment in small-scale embedded generation, then overall energy bills will be driven up.

Secondly, there could be a knock-on effect on efforts to cost-effectively decarbonise the economy. In the 2015 Capacity Market auction, embedded diesel generators bid for long-term contracts of £176m out of £1.1bn. The current value of the demand residual avoidance, at £45/kW, far exceeded the Capacity Market's clearing price, at £18/kW. It is therefore likely that the embedded benefit is partly responsible for a high CO₂ fuel's success in the auction.

Question 2: Do you agree that rising TDR payments to smaller EG is a problem which needs to be addressed?

We agree that these payments need to be addressed. If they are not, they will lead to consumers paying higher costs.

As a general rule, charging methodologies should not encourage behaviour that incentivises additional investment to avoid paying sunk costs, as these sunk costs cannot be recovered. Within the current design of TNUoS, it certainly appears as if inefficient behaviour is being encouraged. If we accept that both

the locational and residual components of the charge are set at an appropriate level, then the charges that sub-100MW embedded generation avoid look difficult to justify.

Question 3: Do you agree with our interpretation of the applicable CUSC objectives?

Yes, we agree with the interpretation of the CUSC objectives.

Question 4: Do you agree with our assessment against the applicable CUSC objectives and statutory duties? Please provide evidence for any differing views.

Yes, we agree with your assessment against the applicable CUSC objectives and statutory duties.

Question 5: In our assessment against the objectives, do you believe there are any relevant assessments we have not taken into account?

Not answered.

Question 6: Do you agree with our assessment that, in this instance, grandfathering as set out in the WACMs would be unlikely to best facilitate the CUSC objectives when compared to the other options available to us?

We agree that grandfathering the change for a specific set of users would be inappropriate. Investment is a risk, and one of the legitimate risks investors face is the closing of loopholes in regulation. It would be wrong for all other users to foot the bill for investments that have not paid off. However, we think changes made at this point in time should be made on an interim basis until the conclusion of the proposed Targeted Charging Review.

Question 7: Do you agree with our assessment that the value of the avoided GSP investment cost best facilitates the applicable CUSC objectives?

We are minded to agree that the avoided GSP investment best facilitates the applicable CUSC objectives in the long term. But we think this issue needs to be looked at in the scope of a holistic review.

Question 8: Do you agree with our assessment of the impacts on security of supply? Please provide evidence for provided views.

Not answered.

Question 9: Please provide evidence to show if there are other cost savings which small EG drive in comparison to larger (over 100MW) EG on the distribution system.

Not answered

Question 10: Is there other evidence that payment above avoided GSP/generation residual would better facilitate the applicable objectives?

See above.

Question 11: Do you believe you have a legitimate expectation or contractual right for the continuation of TDR payments? If so, please provide evidence.

Not answered

Question 12: Do you agree with our assessment of the distributional issues?

Not answered

Question 13: Are there any sectors that we may have overlooked?

We think that there ought to be a consideration of those plants which are accredited under the renewables obligation. If any these close as a result of the removal of TDR benefit it may not be possible for these to be automatically re accredited.

Question 14: Do you agree with our modelling approach?

In general we are happy with the modelling approach - however we have highlighted three areas (see above) where we have concerns which are not accounted for in the overall assessment of the models.

Question 15: Do you think that our background assumptions and using FES data is an appropriate approximation for status quo?

Not answered

Question 16: Where WACMs are not modelled directly, do you think our assessment is appropriate (see appendix 8 for detail)?

Not answered

Question 17: Of the options available to us, do you agree that WACM4 best facilitates the applicable CUSC objectives?

We agree that WACM 4 best facilitates the CUSC objectives, but in making this decision Ofgem should also consider the impact on consumers.

Question 18: Do you believe that an implementation date of April 2018 best facilitates the applicable CUSC objectives?

Yes we think that action needs to be taken as soon as possible to prevent consumers from facing increased costs caused by the current level of TDR benefit that sub 100 MW embedded generation received. But we think this ought to be an interim measure with the benefits holistically reviewed in Ofgem's proposed Targeted Charging Review.