

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

3rd May 2017

Dear Judith

Consultation on Ofgem's Targeted Charging Review (TCR)

The British Hydropower Association [BHA] welcomes the opportunity to comment on this consultation.

The BHA is the professional trade body with over 230 members dedicated to representing the interests of the UK hydropower industry and its associated stakeholders in the wider community at regional, national and global levels. Membership of the association is open to any organisation or individual involved in or with an interest in hydropower.

Members include generators [from Pico to large, run-of-river, tidal range and storage], design and consulting engineers in all disciplines, developers and owners, contractors, operators, equipment and component manufacturers and suppliers, project managers, financiers and investors, insurers and environmental specialists.

The BHA understands why there is concern that the current transmission and distribution network charging signals are no longer fit for purpose and hence can understand the need for a Targeted Charging Review. However, the BHA is gravely concerned that this review could result in a significant impact on all our members.

Hydropower, by its very nature, is capital intensive, lasting many decades. When Government introduced the Feed-in Tariff [FIT] support mechanism, it did so recognising the high capital cost associated with the construction and the benefit of longevity of operation.

The FIT support mechanism was calculated to make projects financially viable and was based on the known cost base at the time. Hence, any subsequent changes to this cost base could have a major impact on the future financial viability of these schemes.

We note that the driver for this consultation is for a more price reflective residual network tariff element and the economic theory that residual charges should be such that users do not change their behaviour as a result of the charging signal.

The BHA supports the view that the residual charging signal should be such that users don't change their behaviour; however, we argue that once a user has reacted to the charging signals and made a long-term investment commitment, they should then be protected from major changes to costs through a major revamp of the charging regime. That the consultation document supports this view is welcome - (1.16 "Different types of generation receive different levels of support under Government policies. In reviewing charges, it is not our intention to set charges that add to that support, nor effectively reduce it.").

Hence, although the charging signal is considered no longer cost reflective, our members have made long-term investment decisions based on the costs of construction and ongoing operation at the time. Our members do not have the opportunity to react to changes in regime, hydropower generators by their very nature react to changing weather conditions, not commercial signals.

The BHA urges Ofgem to exercise great caution in conducting this review and wish to be actively involved in any review to represent the views of an important and significant community involved in renewable energy.

Our response is structured to answer the 22 questions asked in the consultation and we have highlighted the following important points;

- Our concerns are aligned with considerations that Ofgem is required to be mindful of as set out in part 1.20 of the consultation document, namely the protection of sustainable development, the ability of companies to finance their activities and the principles of better regulation.
- The Government, in designing the Feed-In Tariff support regimes, supported the ongoing development of hydropower. The support mechanism was based on the known costs (and available income sources) at the time;
- The very nature of these schemes results in generation output being driven almost entirely by weather conditions, and hence there are no mitigating factors that can be taken if there are major financial impacts from a charging scheme;
- Small scale Feed-In Tariff generators don't access the market in the way described and as such we don't distort the market;
- When considering market distortion, Ofgem need to factor in all costs; in the document, there is a focus solely on embedded benefits;
- There is a distinction to be made between a market distortion - an undesirable facet whereby costs/benefits accrue more favourably in some cases than in others with no counter benefit to the transmission and distribution networks - and consideration related to practices that do bring overall benefit, such as distributed, embedded, renewable generation

projects. These benefits seem to be ignored in these proposals to the unfair detriment of those who have deployed local generation schemes.

- Connection charging methodologies differ between Transmission and Distribution and hence need to be factored into any analysis on advantages/disadvantages;
- Any remedy for market distortion has to be focused on dealing with the market distortion and not penalise small-scale generation that does not distort the market;
- Hence, we strongly believe that Ofgem shouldn't be doing anything that undermines the underlying assumptions that Government used to set these support mechanisms;
- Hence we advocate that grandfather rights are more than appropriate for the hydropower sector.

We would very much welcome the opportunity of meeting with Ofgem officials to discuss these points in greater detail and to discuss with Ofgem the role that the BHA can play in this vitally important review.

Yours sincerely

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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: The BHA understands the concern Ofgem has regarding residual charges. We are however very concerned that our members who have made very long term investment decisions based on the known costs of the day, could be adversely impacted by any review. If the goal is to have a residual charging signal that users do not react to, **then as of equal importance, is that users who have made long-term investment decisions based on the previous, if imperfect signals, should not suffer financial consequences from a change in the charging regime.**

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

Answer 2: Any action to change the signal to a more cost reflective signal must be matched by protection for those who made long-term investment decisions based on the previous charging regime.

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 have seen with the proposed 'Minded to decision' on the TRIAD element the unintended consequences of dealing with the charging regime in a piecemeal fashion. The residual charging regime recovers fixed revenue through multiple charges/payments from multiple user groups. Hence, a change to one charging signal to one user group will have a knock-on impact to the others due to the fixed revenue that has to be recovered. Hence, it is only right that all elements are considered together.

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, as long as we include protection for those that made long term investor decisions based on the existing signal.

Question 5: Are there other approaches that you know about from other jurisdictions, that you think offer relevant lessons for GB?

Answer 5: We have no knowledge of any other approaches.

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.

Answer 6: We note Ofgem's three principles and would add a fourth; Protection for those who made long term investment decisions based on the current regime and cannot mitigate the impacts of a regime change. We believe that this has to be a specific principle given the significant impact that any decision could have on our members.

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?

Answer 7: We believe that any new charging regime needs to protect those investors who made long-term investment decisions and cannot mitigate the impact of a regime change. **If structural changes are being considered, it must be countered with grandfather rights protection.** Due to the very long term nature of these Government-incentivised investments and since hydropower generators do not have the option of responding to these proposed changes other than by shutting down, transitional arrangements are not a reasonable alternative.

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: We believe that any new charging regime needs to protect those investors who made long-term investment decisions and cannot mitigate the impact of a regime change. **If structural changes are being considered, it must be countered with grandfather rights protection.**

Question 9: Do you support any of the five options we have set out for residual charges below, and why?

Answer 9: We have no strong opinion for any of the 5 options and we approach this from the perspective of no material financial impact on our members who have committed to long-term investment decisions based on the current regime.

Question 10: Are there other options for residual charges that you think we should consider, and why?

Answer 10: We believe that the 5 options being considered are sufficient.

Question 11: Are there any options that you think we should rule out now? Please say why.

Answer 11: We believe that all options should be considered in stage 1 of the review and hence wouldn't rule any options out prior to the start of the review.

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: **The BHA is very 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.**

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: **The BHA is very concerned by Ofgem's approach to this perceived issue.**

Embedded generation is considered as behaving and reacting to the market identically and in trying to deal with the impact that a few embedded generators have had on the market, it is in danger of once again penalising the vast majority of embedded generation that have no impact on the market. 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 negates these support mechanisms. We urge Ofgem to recognise that any change to the charging regime undermines the principles on which the support mechanisms were calculated and by default, changes the fundamental financeability of these schemes

Question 14: Of the embedded benefits listed in our table, do you think that any should be a higher or lower priority?

Answer 14: As per our detailed answers to 13, we believe that Ofgem must consider the support mechanism received by small scale generators to make them financially viable are based on the existing charging arrangements and costs and that any change will undermine these support mechanisms. **We strongly believe that Ofgem shouldn't be doing anything that undermines the underlying assumptions that Government used to set these support mechanisms.**

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 have some concern that the issue of storage has only been considered from the perspective of network charges for storage that uses electrical energy as its primary source. By its very nature, storage that uses electrical energy as its primary source does use the network twice, once to charge and the other to discharge. By reducing network charges, there could be a distortion of the storage market at the expense of those storage methodologies that don't use electrical energy as the primary output (such as hydro storage) but has other costs associated with the different primary source. We therefore urge Ofgem to consider this issue carefully to avoid distorting the storage market.

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: A change to one charging signal to one user group will have a knock-on impact to the others due to the fixed revenue that has to be recovered. Hence, it is only right that all elements are considered together to ensure consistency and fairness across all sectors.

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. Although ultimately any changes to the charging regime will not impact overall what consumers pay, there will be winners and losers in the "energy system". The industry is dominated by large players who play multiple roles in the energy system and hence as such are hedged against the winners and losers in the overall system. Hence, we believe it is imperative that Ofgem include stakeholders that represent unique parts of the energy system to ensure fairness. The BHA would welcome the opportunity to form part of the CCG.

Question 21: Do you agree with our proposed delivery model, including its scope?

Answer 21: We agree with the proposed delivery model.

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: We agree.