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26th September 2016

Dear Frances,

Charging arrangements for embedded generation – Ofgem open letter, 29th July 2016

The British Hydropower Association [BHA] is the professional trade body representing the interests of the UK hydropower industry and its associated stakeholders in the wider community at regional, national and global levels.

The BHA welcomes Ofgem's decision to assess whether consumer and system-wide benefits can be derived from changes to current charging arrangements for embedded benefits. The BHA position is very much aligned with that of the Scottish Government and therefore this response is an endorsement of their position.

Ofgem's long-standing concern with this issue is noted, as is the decision to attach priority to Transmission Use of System (TNUoS) demand residual payments. We support Ofgem's aim to address rising costs and the associated distortive impacts on the energy system caused by an overvaluation of embedded benefit payments.

While the BHA support the principle that increasing the cost-reflectivity of TNUoS payments can deliver consumer and energy system savings, we have significant reservations regarding the process adopted by Ofgem. We urge Ofgem to reconsider its decision not to address embedded benefits through a Significant Code Review.

Ofgem's preference for a timely resolution is understandable given large and rising demand residual payments. However, the speed and approach through which a resolution is being sought will have unforeseen, far-reaching consequences.

The reverberating effect that changes to charging arrangements for embedded generation will have throughout the energy system, merit the design and implementation of changes that are transparent, understandable and cost-reflective in practice as well as theory. The striking level of uncertainty across the electricity sector as to what increasing the cost-reflectivity of TNUoS payments would mean in practice indicates that adequate time is needed for a robust, impartial assessment of

the value of embedded generation on the network. This impartiality can only come from Ofgem and through a considered, whole-system review of embedded benefits.

The BHA also seeks assurance from Ofgem that at a time of increased recognition of the cost and flexibility benefits of more distributed generation, changes to embedded benefit charging arrangements will not offset progress in this area.

In line with the Ofgem-BEIS Flexibility work programme, we view facilitation of greater decentralisation in the GB energy system as playing a vital role in delivering cost-effective supply for customers, facilitating the transition to a low carbon economy and supporting growth and employment. It is therefore imperative that due consideration is given to the long-term impact on the electricity system from changes to embedded benefits.

Yours sincerely

Simon Hamlyn

Simon Hamlyn
Chief Executive Officer
British Hydropower Association

Annex A.

Ofgem's approach

The open letter alludes to the far reaching implications that changes to TNUoS payments will have. Proposed fixes will lead to embedded generation being treated differently from Demand-Response and behind-the-meter generation. We note the work Ofgem intends to carry out on a “*range of other matters which may require further work and modification*”, an intention to return and address other elements of embedded benefits, and wider but related changes required for Distribution Use of System charges on account of increased active network management, DNO to DSO transition and storage. Following consultation with a range of industry actors and experts, we are of the view that a holistic, whole-system review of embedded benefits would facilitate greater stability and certainty over the long-run and promote a more enduring solution than the approach proposed to date.

Impact Assessment

The BHA is of the firm view that at a minimum Ofgem should carry out a robust impact assessment before any changes are made to current arrangements. We note a particular lack of uncertainty regarding the potential level of system efficiency and consumer benefits to be derived from changes and the revenue and cost implications for a wide array of generation technologies, in particular intermittent renewable generation.

A robust, objective evidence base is required to provide greater confidence that the loss of revenue to embedded generation is justifiable and proportionate to the level of consumer and system efficiency savings to be realised. Moreover, the short- and long-term impact on consumers must be considered in order to encapsulate the potential impact of changes to embedded generation changes on the long-term development of the electricity system.

A robust, forward-looking impact assessment would work to alleviate concerns that a reduction or removal of embedded benefit payments will not have a significant effect on the current renewable energy industry in UK, on future investment in low carbon and on the achievement of renewable, community ownership and carbon targets.

Supporting System Flexibility

Ofgem's Flexibility Position Paper recognised the role for distributed generation in providing “*flexibility, creating opportunities to supply locally and provide other services to market actors*” (*Making the electricity system more flexible and delivering the benefits for consumers*, September 2015). Additional distributed generation can support the anticipated long-term increased penetration of electrical heating and transport in a cost-effective manner. Local generation can reduce the costs of transporting electricity and consumer bills.

To ensure that progress in meeting future challenges is not undermined by additional financial burdens placed on present and future embedded generation, it is imperative that the system-wide and flexibility benefits that embedded generation can provide

are appropriately represented in any remaining value for TNUoS demand residual payments.

Given the level of disagreement highlighted in Connection and Use of System Code work-group consultation documents for the current embedded benefit modifications (the size of the benefit or value of 'X' and how it is distributed by suppliers to generators) indicates that the CUSC panel does not have the clarity to deliver this in the proposed timescale.

If, after such an impact assessment Ofgem was minded to move forward with adjusting the embedded benefits, it will be important to ensure that any increase in revenue due to value being provided in other areas (other than pure Transmission System Utilisation) were timed to ensure that there is not a period where embedded benefits have been removed and flexibility revenues are not available.

Demand Residual

The size of the residual is central to the value of embedded benefit - the TNUoS embedded benefit is approximately defined as the demand residual plus the generation residual. As part of a reconsideration of charging arrangements for embedded benefits, Ofgem should clearly set out the basis and rationale for the size of the residuals. Greater clarity on the purpose of the residuals, what they cover and how this has a bearing on the actual costs that embedded generators may create or off-set would aid this debate.

Capacity Market

The open letter and CMP 265 highlight that perceived charging defects are specific to the operation of the Capacity Market. The BHA considers that other avenues, constituting a capacity market solution, should be considered further as this may be more appropriate than seeking quick remedies through changes to the transmission charging regime.

If the latter does occur, then as part of an Impact Assessment Ofgem should consider the extent to which changes to TNUoS residual demand will work to deliver changes in Capacity Market outcomes sought by the UK Government, set out in the DECC Capacity Market Reform Consultation March 2016.