CUSC Workgroup Consultation Response Proforma

CMP324 and CMP325: Generation Zones – changes for RIIO-T2 and Rezoning – CMP324 expansion

Industry parties are invited to respond to this consultation expressing their views and supplying the rationale for those views, particularly in respect of any specific questions detailed below.

Please send your responses to cusc.team@nationalgrideso.com by **5pm** on **18 March 2020**. Please note that any responses received after the deadline or sent to a different email address may not receive due consideration by the Workgroup.

If you have any queries on the content of this consultation please contact Joseph Henry joseph.henry2@nationalgrideso.com or cusc.team@nationalgrideso.com.

Respondent details	Please enter your details
Respondent name:	John Tindal
Company name:	SSE plc
Email address:	John.tindal@sse.com
Phone number:	01738 457 308

For reference the applicable CUSC objectives are:

a. *That compliance with the use of system charging methodology facilitates effective competition in the generation and supply of electricity and (so far as is consistent therewith) facilitates competition in the sale, distribution and purchase of electricity;*

b. *That compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs (excluding any payments between transmission licensees which are made under and accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard licence condition C26 requirements of a connect and manage connection);*

c. *That, so far as is consistent with sub-paragraphs (a) and (b), the use of system charging methodology, as far as is reasonably practicable, properly takes account of the developments in transmission licensees' transmission businesses;*

d. *Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency. These are defined within the National Grid Electricity Transmission plc Licence under Standard Condition C10, paragraph 1 *; and*

e. *Promoting efficiency in the implementation and administration of the CUSC arrangements.*

**Objective (d) refers specifically to European Regulation 2009/714/EC. Reference to the Agency is to the Agency for the Cooperation of Energy Regulators (ACER).*

Please express your views regarding the Workgroup Consultation in the right-hand side of the table below, including your rationale.

Standard Workgroup Consultation questions		
1	Do you believe that the CMP324 and CMP325 Original Proposal better facilitates the Applicable CUSC Objectives?	Yes, overall, CMP324/325 better facilitates the applicable CUSC objectives. Further details below. **a) <u>Effective competition – Better</u>** **Reduced developer risk margins results in lower cost to customers** – Once a large transmission connected power station has been built, the operator can no longer respond to changing TNUoS price signals until the power station approaches the end of its life. Therefore volatility of TNUoS charges simply represents a volatile risk which the operator must absorb over the life of a generating station. This means that developers need to price in risk margins when making investment decisions, which results in higher costs to customers. The Original should result in better predictability, reduced risk margins, so lower cost to customers. **Increased stability results in more economically efficient generation investment decisions –** Original will provide a more effective price signal. This is because TNUoS tariffs will tend to be more predictable, so parties will have greater certainty of future TNUoS charges over the lifetime of a generating station at the point they make their final investment decision. This will enable participants to make more economically efficient investment decisions. By contrast, an unpredictable charge, even if it were perfectly cost reflective, would provide a relatively poor price signal because developers cannot respond to a charge if they don't know what it is going to be. Developer uncertainty within the Baseline distorts competition because, in as far as developers may try to take account of differences in locational tariffs when competing in markets, such as the CfD auction, or capacity mechanism, then the outcome would be in part be affected by differences in the forecast error between different developers regarding what future TNUoS charges may be instead of genuine economic fundamentals.

Even if locational price signals became less sharp, or accurate, this is still consistent with better effective competition - This is because power station investment decisions are primarily driven by factors other than TNUoS charges. For renewables, the primary drivers of locational investment decisions include resource availability and planning consent (which tend to mean rural/remote, rather than urban, areas away from demand centres). For large thermal power stations, the primary drivers for investment decisions include access to cooling water, re-use of existing (brownfield) power station site for planning consent purposes, access to CCUS transport and storage of Carbon.

Better align charging signals between generation and demand – By making the definition of zones consistent, the Original would better align TNUoS price signals for transmission connected generators compared with distribution connected generators, generators located behind demand meters and with demand. The Original proposal would be a step in the right direction towards greater harmonisation, while there may be scope for even further harmonisation through the future outcome of Ofgem's Access and Forward Charges SCR.

b) <u>Cost reflectivity - Neutral</u>

Overall, the effect of the Original on the cost reflectivity of tariffs will be broadly neutral compared with baseline. The ESO tariff distribution analysis in annex showed the distribution of tariffs within each zone to be of broadly similar range for the current 27 zones compared with using the DNO zones.

c) <u>Developments in transmission licensees transmission businesses – Neutral</u>

d) <u>Compliance with the Electricity Regulation and any relevant legally binding decision of</u>

		the European Commission and/or the Agency – Neutral **e) Efficiency in implementation and administration – Better** By fixing the zones and connectivity map, this would improve: **Administrative work for generators** – Avoids the need for generators to carry out modelling and commercial analysis regarding what the potential impact of future re-zoning on business cases **Improves efficiency of tariff setting and publication** – ESO can provide more accurate 5 year forecasts of TNUoS tariffs without having to take account of the risk that the generation charging zones could substantially change which would make the ESO published 5 year tariffs obsolete and inaccurate. **Improve efficiency of tariff setting process** – Avoids the need for the ESO to carry out regular re-zoning calculations to define the zones and also to inform industry of potential risks associated with potential future re-zoning. This is particularly relevant since the baseline administrative burden of re-zoning is not justified by benefits elsewhere because it is detrimental for both industry and customers. The detriment arises because it results in worse uncertainty, worse economic efficiency of developer decision making, and more expensive risk margins at higher cost to customers.
2	Do you support the proposed implementation approach?	Yes
3	Do you have any other comments?	Not at this time
4	Do you wish to raise a Workgroup Consultation Alternative Request for the Workgroup to consider?	**Consider using one single generation charging zone** It would be appropriate for the Workgroup to consider an alternative of using one single generation charging zone.

		We would suggest there will tend to be an optimum definition, or optimum range of charging zones, because of a trade-off between effective competition, proportionality and practicality and cost reflectivity. Cost reflectivity is not an end in itself, but it is only useful in as far as it better facilitates effective competition to facilitates a more economically efficient system at lower cost to customers. However, because of the challenges to delivering sufficient low carbon generation to meet the Government's net zero carbon commitments, locational TNUoS tariffs are no longer socially, or economically beneficial. By contrast, the key driver of location of new low carbon generation will be fundamentals factors such as resource availability, planning restrictions, access to cooling and transportation for CO2 from CCUS. In this regard, the investor uncertainty caused by volatile locational TNUoS charges simply add risk to developers which will tend to increase the overall cost to customers of delivering the government's net-zero carbon commitments.
Specific CMP324 and CMP325 Workgroup Consultation questions		
5	What are your views on the potential solutions discussed in the report? Please provide any evidence or rationale for your preferred solution.	We have provided views on each of the other potential solutions below: **<u>Fix current 27 zones</u>** This would be a good solution and potentially as good as the Original. • It would avoid a one-off tariff shock to generators from changing generation charging zones • It would deliver the same long-term benefits of reducing TNUoS tariff volatility caused by regular re-zoning • It would be broadly as cost reflective as the Original with the ESO tariff distribution analysis showing similar spreads of "Year Round Prices" in either solution • It would be as practical as the Original because it would also remove any

requirement for the ESO to recalculate charging zones at each price control

- A particular advantage of this approach is that it would avoid unnecessary volatility in generator tariffs due to re-zoning in advance of the result of Ofgem's Access and Forward Looking Charges (AFLC) SCR. There would be a benefit in fixing the zones as they currently are, then reconsidering the question of zoning after the result of the AFLC SCR.

Inflating in line with RPI

Worse than Original regarding cost reflectivity for Southern conventional generators - Inflating by RPI would fail to deliver the cost reflectivity benefit which is suggested. This is because for Southern conventional generators, the primary differentiator in modelled cost by location is provided by the Peak Security tariff element, not the Year Round tariff element. However, in practice, it is the Year Round element which is used to define the generator charging zones, while the Peak Security element is not used at all in the zoning calculation. The Year Round tariff element is a poor method to use to define southern charging zones because in those Southern zones, it is relatively low magnitude and flat across southern zones and after power station ALF is applied, it represents a relatively small proportion of the TNUoS charge paid by southern thermal generators. This issue is particularly relevant for low load factor peaking plant and will become even more relevant over the next few years because thermal power station load factors, and associated ALFs, are likely to continue to reduce as an increasing proportion of electricity demand is served from renewable sources.

It is important to note that the tariff distribution graphs produced by ESO shown in Annex 9 only relate to "YR Nodal Price" tariff element. They do not take account of the effect of differences in the Peak Security tariff element and they do not reflect the spread of actual TNUoS charges which generators would pay.

		Worse with regard to effective competition – Even if it were more cost reflective, then the higher granularity compared with DNO areas would not better facilitate effective competition. This is partly because it would fail to deliver the benefits of the Original, so would leave in place the existing baseline detrimental issues including greater volatility of charges at times of re-zoning, higher risk and associated risk margins, as well as distorted competition based on developer errors in forecasting future TNUoS tariffs. This is also because power station investment decisions are primarily driven by factors other than TNUoS tariffs. For renewables, the primary drivers of locational investment decisions include resource availability and planning consent. For large thermal power stations, the primary drivers for investment decisions include access to cooling, planning consent, access to CCUS transport and storage of Carbon. **ETYS Zones** Agree with the Workgroup proposal to not progress this option. It would be worse than the Original, worse than the option to inflate in line with RPI and worse than Baseline. It would fail to deliver tariff stability and would result in tariffs which were even more volatile and even less cost reflective than any of the other options. This was illustrated by the ESO price distribution graphs in annex 9.
6	What are your views on the distributional effects of the potential solutions outlined? Please provide your rationale.	Each of the options would have a different impact on distributional effects between parties: **Fix current 27 zones** – This would be the best option in terms of avoiding detrimental distributional effects because definition of zoning would remain as it is. **DNO zones** – This would have a one-off distributional effect when it is introduced, but would thereafter avoid causing further detrimental distributional effects because there would be no need for future re-zoning **Inflate in line with RPI** – This would cause substantial detrimental distributional effects both in

		its introduction and also regularly in the future whenever the ESO redefined the zones in line with price controls. This distributional effect could not even be justified by better cost reflectivity because, as described above, this approach to zoning is not cost reflective because it does not take account of the Peak Security element and does not reflect the TNUoS charges which generators actually pay. **ETYS zones** - As with inflating by RPI, this would cause substantial distributional effects both in its introduction and also regularly in the future whenever the ESO redefined the zones in line with price controls. This distributional effect could not even be justified by better cost reflectivity because the use of ETYS zones would be even less cost reflective than inflating by RPI.