

Centrica plc
Regulatory Affairs
Millstream
Maidenhead Rd
Windsor
SL4 5GD
www.centrica.com

Ruben Pereira,
Policy Manager
Electricity Network Charging
Ofgem
10 South Colonnade,
Canary Wharf,
London E14 4PU

19 January 2022.

Sent by email to: ElectricityNetworkCharging@ofgem.gov.uk

Dear Ruben,

CMP308 – Minded-to decision and draft impact assessment

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group.

If BSUoS charging reform is implemented appropriately then we consider it may lead to some of the benefits highlighted in the minded-to decision. However, we have significant concerns with the current minded-to decision to implement CMP308.

In our view a decision to implement CMP308 from April 2023 is dependent on:

- **A decision to implement CMP361¹ from the same date (or earlier)**
- **Confirmation that the price cap methodology will be revised to include the higher BSUoS costs from the date of implementation**
- **Confirmation that existing CfD strike prices will be adjusted to remove the BSUoS compensation element from the date of implementation**

If these concerns are not addressed, then we cannot support a decision to implement CMP308 from April 2023.

In our response to the Code Administrator Consultation for CMP308² we were clear that when assessed against the current CUSC baseline, we consider CMP308 will have a **negative impact** on the applicable objectives. However, we noted that should a reasonable CMP361 solution be implemented at the same time as CMP308 (or earlier) and should Ofgem confirm that the price cap methodology be revised to ensure that the increase in BSUoS costs would be allowed for

¹ CMP361: BSUoS Reform: Introduction of an ex-ante fixed BSUoS tariff

² CMP308 Final Modification Report Annexes available [here](#)

from the point of implementation, then the negative impacts we identified with CMP308 would be largely mitigated, leaving a positive impact on competition in generation.

We also noted in our Code Administrator Consultation response that a key assumption made by Frontier Economics in its impact assessment was that “*CfD strike prices for any contracted plant paying BSUoS charges will be adjusted down when its BSUoS charges are removed*”. Our assessment against the CUSC objectives relied on this assumption but we requested that Ofgem seek assurances that this will be the case for all CfD agreements, and implicitly that the adjustment would be made in a timely manner.

Therefore, we are alarmed that the minded-to decision has highlighted the risk that this may not be the case – which Ofgem suggests could result in excess of £200m of additional consumer costs in the near term. It is also surprising that Ofgem appears to consider the change to be beneficial even if that risk materialises. Given the current pressure on household energy bills, and the fact that the £320m of modelled consumer benefits are necessarily uncertain, and do not appear to become net positive until the mid-2030s, we do not believe a decision to implement CMP308 from 1 April 2023 is in consumer interests unless this risk of additional consumer costs from CfD agreements has been mitigated.

In Appendix One we provide answers to the consultation questions. I hope you find these helpful.

Please contact George Moran in the first instance if you have any questions.

Yours sincerely,

Kirsty Ingham
Head of Industry Transformation,
Governance & Forecasting
Centrica Regulatory Affairs & Policy

George Moran
Senior Regulatory Manager,
Industry Transformation, Governance &
Forecasting
Centrica Regulatory Affairs & Policy

Appendix One: Consultation Questions

1. Do you agree with our assessment that CMP308 better facilitates the Applicable CUSC Objectives?

Our assessment of CMP308 is against the current CUSC baseline, and strictly on that basis, we consider it will have a **negative impact** on the applicable objectives.

However, as set out above, should CMP361 be implemented at the same time as CMP308 (or earlier), and should our concerns surrounding the price cap methodology and CfD strike prices be addressed, then the negative impacts we identify below would be largely mitigated, leaving the possible positive impact on competition in generation.

Applicable CUSC Objective (a): Negative impact.

The current methodology for setting the retail price cap includes a delay in reflecting changes in the level of BSUoS costs within the cap. Therefore, without a change to the retail price cap methodology, suppliers will face significant and unjustified losses due to the higher BSUoS costs that would result from CMP308 not being reflected in the price cap from the point of implementation. If an efficient supplier is unable to recover its costs, then this will adversely affect competition in supply.

The volatility of BSUoS costs has increased in recent years. Currently the portion of balancing costs paid by generation is incorporated into the power price, which suppliers can hedge against. Therefore, recovering all BSUoS costs from suppliers will lead to an increase in the uncertainty of BSUoS related costs and cash flows. Suppliers will have varying abilities to manage this increased uncertainty, with a resultant negative impact on competition in supply.

There may be a positive effect on competition in generation from CMP308 partially offsetting these negative impacts, but overall, we disagree with Ofgem's assessment that CMP308 better facilitates applicable objective (a).

Applicable CUSC Objective (b): Negative impact.

BSUoS is currently a cost recovery charge, providing no useful cost reflective forward-looking signal. It can encourage responses that are inefficient and increase system costs e.g., reducing demand to avoid high BSUoS costs caused by excess generation in a zone. CMP308 would double the strength of these distortive signals, making it less cost reflective than the baseline. Therefore, we disagree with Ofgem's assessment that CMP308 better facilitates applicable objective (b).

Applicable CUSC Objectives (c), (d) and (e): Neutral impact.

We consider CMP308 has a neutral impact on these objectives. We do not believe CMP308 by itself simplifies billing arrangements and any process improvements brought by a new billing system are as yet unproven. Therefore, we disagree with Ofgem's assessment that CMP308 better facilitates applicable objective (e).

2. Do you agree that charging BSUoS charges only to Final Demand reduces distortions between Large Generators and other forms of generation? Please explain why.

CMP308 will reduce the distortion between those generators that currently pay BSUoS and those that do not. Taken in isolation, it could be assumed that this should lead to more efficient outcomes.

However, there are advantages and disadvantages of being connected at distribution level. Generators connecting at transmission level benefit from the Connect and Manage regime, a shallow connection boundary and financially firm access rights. These benefits are not currently available to distribution-connected generators and these differences could create: undue barriers to entry at distribution; distortions between transmission- and distribution-connecting projects; and/or inefficient network development.

If charging reform focuses solely on removing the 'benefits' associated with connecting generation at distribution level relative to transmission but does not address the 'benefits' of connecting generation at transmission level relative to distribution, then 'in the round' the outcome could be a less level playing field than today.

We have provided our views on ensuring a genuine level playing field between transmission- and distribution-connected generation in our responses to Ofgem's minded-to decision on the Access and Forward-looking Charges Significant Code Review and Call for Evidence on Transmission Network Use of System Charges.

3. Do you have any views on the impact of this proposal on Behind The Meter Generation and its competitiveness?

Our understanding is that CMP308 should have a broadly neutral impact on the competitiveness of Behind The Meter Generation (BTMG). This is because whilst CMP308 will allow BTMG to avoid a higher demand BSUoS rate, this will be (more than) offset by a reduction in the avoidable costs associated with wholesale, low carbon levies and capacity market resultant from the removal of BSUoS from generation. The net position should be broadly neutral relative to today.

If CMP361 is implemented, this would reduce the remaining distortion with front of meter generation since a flat rate BSUoS price would avoid the excessive peak BSUoS prices that can be observed under the current regime. This would significantly reduce the ability of BTMG to appear cheaper than more efficient generation and be dispatched 'out of merit' during these high-cost BSUoS periods.

4. Do you have any views on our reasoning on this proposal's effect on price signals or generation dispatch?

CMP308 will reduce the distortion between those generators that currently pay BSUoS and those that do not. Taken in isolation, it could be assumed that this should lead to more efficient generation dispatch. However, the current BSUoS charging methodology can encourage responses that are inefficient and increase system costs e.g., reducing demand to avoid high BSUoS costs caused by excess generation in a zone. CMP308 would double the strength of these distortive signals.

5. Do you have any views on our reasoning on this proposal's effect on competition between different generator types?

CMP308 will reduce the distortion between those generators that currently pay BSUoS and those that do not. Taken in isolation, it could be assumed that this should lead to more efficient outcomes.

However, there are advantages and disadvantages of being connected at distribution level. Generators connecting at transmission level benefit from the Connect and Manage regime, a shallow connection boundary and financially firm access rights. These benefits are not currently available to distribution-connected generators and these differences could create: undue barriers to entry at distribution; distortions between transmission- and distribution-connecting projects; and/or inefficient network development.

If charging reform focuses solely on removing the 'benefits' associated with connecting generation at distribution level relative to transmission but does not address the 'benefits' of connecting generation at transmission level relative to distribution, then 'in the round' the outcome could be a less level playing field than today.

We have provided our views on ensuring a genuine level playing field between transmission- and distribution-connected generation in our responses to Ofgem's minded-to decision on the Access and Forward-looking Charges Significant Code Review and Call for Evidence on Transmission Network Use of System Charges.

6. Do you have views on our assessment of the decarbonisation impacts of this proposal, both in respect of emissions from the GB energy system and of overall emissions?

Not answered.

7. Do you have views on whether and the extent to which the changes proposed in this modification have already been incorporated into supplier decisions?

Ideally, implementation would have been set at 'x' years following a final decision as only this approach provides the certainty suppliers (and generators) require to confidently price BSUoS appropriately into longer term contracts. We acknowledge that Ofgem have signalled an April 2023 implementation date since December 2020. However, this was a qualified opinion based on the information available at that time and whilst there remains any uncertainty surrounding implementation timescales, it is likely that different suppliers (and generators) will have made different assumptions on BSUoS arrangements which will affect the degree to which the costs and benefits of the change will be reflected in commercial decisions.

8. Do you have views on the impact of this proposal on existing supply contracts, including the possibility of costs or delayed benefits to consumers stemming from windfall gains to industry parties, or double payments?

We have significant concerns with the risk highlighted on CfD payments. It would clearly lead to windfall gains for generators and significant additional consumer costs if existing CfD generation continued to be compensated for BSUoS charges that they are no longer facing. We do not believe a decision to implement CMP308 can be made until this risk has been addressed.

9. Do you have views on this proposal's impacts on generator and supplier risks, including on exposure to volatile charges?

There is a clear structural market difference between generators and suppliers with respect to BSUoS. The generation community receives the majority of the revenues behind BSUoS costs. This means that if BSUoS costs are higher (lower) than expected then it is highly likely that generators, as a whole, will have received higher (lower) revenues. Because of this structural difference we consider current BSUoS risk cannot be assumed to be equivalent between generators and suppliers.

It seems self-evident that generators face lower BSUoS risk than suppliers. This is because generators, taken as whole, should be able to mitigate some, if not all, of the risk of higher BSUoS with the opportunity for additional constraint/ancillary service payments. For example, a generator who is active in the BM who is exposed to significantly higher BSUoS costs than expected has the opportunity to change or reverse out its contracted position in the market and offer its services in the BM, thus receiving payments which mitigate the expected higher BSUoS cost. Suppliers do not have this opportunity.

We believe that CMP308 would result in an increase in net risk premia.

10. Do you have views on the interactions between this proposal and other changes in the sector, including other BSUoS charging reform proposals?

CMP361 (Introduction of an ex-ante fixed BSUoS tariff) is currently going through the CUSC change process and we consider CMP361 is a pre-requisite for CMP308.

As we have already highlighted, whilst CMP308 will reduce the distortion between those generators that currently pay BSUoS and those that do not, there are advantages and disadvantages of being connected at distribution level. Generators connecting at transmission level benefit from the Connect and Manage regime, a shallow connection boundary and financially firm access rights. These benefits are not currently available to distribution-connected generators and these differences could create: undue barriers to entry at distribution; distortions between transmission- and distribution-connecting projects; and/or inefficient network development.

If charging reform focuses solely on removing the 'benefits' associated with connecting generation at distribution level relative to transmission but does not address the 'benefits' of connecting generation at transmission level relative to distribution, then 'in the round' the outcome could be a less level playing field than today.

We have provided our views on ensuring a genuine level playing field between transmission- and distribution-connected generation in our responses to Ofgem's minded-to decision on the Access and Forward-looking Charges Significant Code Review and Call for Evidence on Transmission Network Use of System Charges.

11. Do you have views on the modelled assessment of consumer and energy system benefits? Please provide quantitative analysis and any further information.

We are alarmed that the minded-to decision has highlighted the risk that existing CfD Generators may continue to be compensated for BSUoS even when they are no longer paying BSUoS – which Ofgem suggests could result in excess of £200m of additional consumer costs in the near term. It is also surprising that Ofgem appears to consider CMP308 to be beneficial even if that risk materialises. Given the current pressure on household energy bills, and the fact that the £320m of modelled consumer benefits are necessarily uncertain, and do not appear to become net positive until the mid-2030-s, we do not believe a decision to implement CMP308 from 1 April 2023 is in consumer interests unless this risk of additional consumer costs from CfD agreements has been mitigated.

12. Is our assessment of non-monetised costs and benefits reasonable? Are there any other factors we should consider?

Not answered.

13. Do you consider the consumer and system benefits identified in our consultants' modelling to represent a reasonable view of the potential effects of this modification?

We are concerned that the impact assessment is based on arrangements that have not been confirmed. A key assumption made by Frontier Economics in its impact assessment is that *"CfD strike prices for any contracted plant paying BSUoS charges will be adjusted down when its BSUoS charges are removed"*.

Ofgem has highlighted that there is a risk this assumption may not hold and have estimated this near-term risk to be in excess of £200m to consumers, but have not explained the assumptions or modelling used to arrive at this figure. We consider that given this risk, the impact assessment needs to be revisited and assume that there is no change to existing CfD contracts – unless Ofgem can provide the necessary assurances that the risk has been addressed. We believe implementation from April 2023 should be contingent on all existing CfD generator agreements being amended to remove the BSUoS compensation element from that date. It is difficult to see why existing CfD generators would be willing to alter their CfD agreements if Ofgem has already decided to implement CMP308.

14. Do you consider that Ofgem has duly considered all relevant consumer and system benefits? Are there any areas which could benefit from further analysis?

The impact assessment needs to be revisited and assume that there is no change to existing CfD contracts – unless Ofgem can provide the necessary assurances that the risk has been addressed.

15. Our modelling assumes that CfD adjustment payments designed to compensate contract holders for the BSUoS charges they face will no longer be paid in the event generation is not liable for BSUoS charges. Do you agree with this assumption, and do you have views on our assessment of the risks associated with existing CfD contracts?

Unless Ofgem can provide the necessary assurances that this will be the case then this is a flawed assumption with significant impacts on the modelled benefits of the change.

Ofgem has estimated this near-term risk to be in excess of £200m to consumers, but have not explained the assumptions or modelling used to arrive at this figure. We consider that given this risk, the impact assessment needs to be revisited and assume that there is no change to existing CfD contracts – unless Ofgem can provide the necessary assurances that the risk has been addressed. We believe implementation from April 2023 should be contingent on all existing CfD generator agreements being amended to remove the BSUoS compensation element from that date. It is difficult to see why existing CfD generators would be willing to alter their CfD agreements if Ofgem has already decided to implement CMP308.

16. Do you have views on the impacts of this proposal on end consumers, including large users and vulnerable users?

Not answered.

17. Do you agree with our assessment that reduced costs to generators are likely to feed through into lower wholesale prices?

Not answered.

18. Do you agree with our assessment that this policy will not have any significant material impacts on vulnerable users?

Not answered.

19. Do you agree with our assessment that this modification is unlikely to lead to any significant impacts on essential services or supply chains?

Not answered.

20. We would note that increases in demand costs will need to be incorporated into the Price Cap methodology. Do you have any views on this area?

The BSUoS element of the price cap methodology is currently set on a lagged pass-through basis. CMP308 will almost double the level of BSUoS costs faced by suppliers from the point of implementation but under the existing lagged pass-through approach the impact of a new and much higher demand only BSUoS charge would not be fully included in the price cap for 18 months post implementation. This would create a significant risk for suppliers that they would be unable to adequately fund increased BSUoS costs.

We note that the price cap issue was also considered by the Second BSUoS Task Force. The Task Force recommended a demand only charge that was fixed in advance and recommended that Ofgem include the new fixed BSUoS price in the price cap from the point of implementation, including any necessary adjustment to true up allowances for cap periods before the move to an ex-ante approach. We agree with the recommendations of the Task Force and we believe that CMP308 cannot be implemented unless there is a change to the price cap methodology.

21. Do you agree with our proposed implementation date of 1 April 2023? Please provide your reasoning.

In our view a decision to implement CMP308 from April 2023 is dependent on:

- A decision to implement CMP361 from the same date (or earlier)
- Confirmation that the price cap methodology will be revised to include the higher BSUoS costs from the date of implementation
- Confirmation that existing CfD strike prices will be adjusted to remove the BSUoS compensation element from the date of implementation.

If these concerns are not addressed, then we cannot support a decision to implement CMP308 from April 2023.

22. Do you have any other information which is relevant to this consultation?

Not answered.