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Dan Norton,
Deputy Director Price Protection,
Ofgem

3 October 2022

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

Dear Dan,

Price cap: Call for input of our approach to reflecting potential changes to BSUoS charges in the price cap

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

We are supportive of this review of the treatment of BSUoS charges in the price cap. We believe:

- **A fixed ex-ante BSUoS tariff should be reflected in the price cap from the point of implementation**
- **A transitional adjustment is required to ensure suppliers have been allowed to recover underlying efficient costs**
- **No reduction to the headroom allowance is justified**

A fixed ex-ante BSUoS tariff should be reflected in the price cap from implementation

As highlighted by Ofgem, the driver for this review of how BSUoS charges are reflected in the price cap is Connection and Use of System Code (CUSC) modification CMP361. This modification proposes that BSUoS charges should take the form of a flat volumetric charge, set in advance and follows the recommendation of the Second Balancing Services Charges Task Force.

We support the recommendations of the BSUoS Task Force and agree that CMP361¹ requires a change to the treatment of BSUoS charges in the price cap. The current lagged pass-through approach exposes suppliers to cash flow risk and a move to a fixed ex-ante charge would allow the true BSUoS costs for a relevant period to be reflected in the price cap. This would bring the treatment of BSUoS into line with all other network cost allowances.

Using the published ex-ante tariff is particularly necessary when considered alongside Ofgem's approval of CMP308². That modification establishes that from April 2023 only Final Demand – rather than demand and generation – will be liable for BSUoS charges. The move to a demand only charge will almost double the resulting BSUoS costs for suppliers and under the current lagged methodology these higher costs would not be fully included in the price cap for 18 months

¹ We note Ofgem has since published a minded-to decision to approve this modification

² CMP308: Removal of BSUoS charge from Generation

post implementation. This would create a risk for suppliers that they would be unable to adequately fund increased BSUoS costs.

For these reasons we agree with Ofgem's minded-to position to adopt the new fixed charge in the price cap from April 2023.

A transitional adjustment is required to ensure suppliers have been allowed to recover underlying efficient costs

We also agree that replacing the lagged nature of the existing methodology with an ex-ante tariff would mean that there would be a period of BSUoS charges incurred by suppliers (January 2022 – March 2023) that would not be fully reflected and recovered through future price caps. This requires a transitional adjustment to ensure suppliers have been allowed to recover underlying efficient costs. We highlighted this in our response to the CMP361 code administrator consultation and we note it was also recommended by the Second Balancing Services Charges Task Force³:

"The Task Force recommend that Ofgem should 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 majority of the positions set out by Ofgem in the Call for Input. Specifically, we agree that Ofgem would need to consider the BSUoS charges from January 2022 up to and including March 2023 when calculating the adjustment. This is because:

- BSUoS charges until the end of December 2021 are fully recovered by the end of cap period 9b (January 2023-March 2023).
- BSUoS charges from January 2022 up to and including June 2022 are partially recovered by the end of the cap period 9b (January 2023-March 2023).
- BSUoS charges from July 2022 up to and including March 2023 are not and would not be recovered through the cap if it were aligned to the ex-ante tariff.

We also agree that it would be appropriate to consider that Suppliers have recovered some BSUoS charges they incurred outside of the cap periods through the cap.

- BSUoS allowances for the early cap periods (January 2019 – March 2020) reflected, to varying degrees, BSUoS costs incurred between July 2017 – December 2018.

Our view is that the necessary adjustment should be equal to the BSUoS charges incurred and not reflected in the cap between January 2022 – March 2023 less the BSUoS allowance received between January 2019 – March 2020 to the extent these reflected costs incurred prior to January 2019. This will ensure that suppliers have recovered only their efficient costs for BSUoS through the price cap.

We are also supportive of Ofgem's preference to use actual data when it is available to make the adjustment (Option A) rather than adopting a float and true up approach (Option B) or waiting until all data is available (Option C). The float and true up approach (Option B) would require unnecessary additional processes carrying out a true-up at a later time and the delayed approach (Option C) would unnecessarily delay the recovery of lagged costs.

We consider that the cleanest and most transparent approach for the transition adjustment would be to base it on the current lagged approach for BSUoS charges i.e. the BSUoS allowance would be based on:

³ Final Report - Second Balancing Services Charges Task Force (p. 27)
Page 2 of 3

- the ex-ante BSUoS charge under CMP361; plus,
- the BSUoS allowance that would have been based on costs from January 2022 – March 2023 under the current lagged recovery approach; less
- the BSUoS allowance that was included in the early price cap periods that reflected periods prior to January 2019.

We have mocked up a simple illustration of how this could work in our accompanying confidential annex.

No reduction to the headroom allowance is justified

Whilst we agree with the majority of the positions set out in the Call for Evidence, we do not agree that any reduction to the headroom allowance is justified. The headroom allowance should be considered holistically rather than on a line-by-line basis, and we have consistently shown in the past that the allowance has been exceeded by costs not accounted for in the price cap⁴.

We also consider the potential uncertainty Ofgem includes in the headroom allowance for BSUoS to be negligible:

- it is based on a 2017 baseline and so will not reflect the higher levels of volatility seen for BSUoS in recent years;
- whilst Ofgem recognised BSUoS uncertainty in its November 2018 decision on headroom, this did not result in any change to the headroom allowance consulted upon in September 2018, implying a negligible effect;
- Ofgem also made clear in its 2018 decision document:
“we note that there is considerable uncertainty over future trends in BSUoS charges, with factors which could cause these to rise or fall in the future. Even if BSUoS charges increase in line with historic trends, the materiality of the impact of the lag on suppliers’ costs is likely to be relatively small.”

If the headroom allowance is to be reviewed for BSUoS, then we consider that it will need to be increased to factor in the risk of in-period changes to the ‘fixed’ BSUoS rates under the proposed ex-ante CMP361 methodology. These would be required if BSUoS costs were significantly higher than assumed when setting the ex-ante charge and may not be captured in the six-monthly update of network charges in the price cap.

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

Yours sincerely,

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⁴ See paragraphs 86-90 of Centrica response to Ofgem’s Consultation on the potential impact of increased wholesale volatility on the default tariff cap, December 2021
 Page 3 of 3