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Dan Norton,
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Ofgem

23 December 2022

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

Dear Dan,

Price cap: Consultation on reflecting potential changes to BSUoS charges in the price cap

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

We are generally supportive of many of the proposals contained in the consultation. We believe:

- **Suppliers must be able to recover the increase in BSUoS costs from April 2023**
- **The allowance should be based on the CMP361 WACM3 tariff, or any revised tariff from a subsequent modification**
- **The ex-ante BSUoS allowance should be reviewed quarterly with adjustments in a future cap to reflect any differences between allowance and outturn**
- **A transitional adjustment is required to ensure suppliers have been allowed to recover underlying efficient costs**
- **The transitional adjustment should be recovered over 12 months and be included in the Market Stabilisation Charge**
- **No reduction to the headroom allowance is justified**

Suppliers must be able to recover the increase in BSUoS costs from April 2023

Following the approval of code modification CMP308¹ to remove BSUoS charges from generators, the BSUoS costs faced by suppliers will almost double from April 2023. Under the current lagged methodology these higher costs would not be fully included in the price cap for 18 months post-implementation leading to a substantial under-recovery by suppliers which, in the current fragile market conditions, could contribute to further failures.

¹ CMP308: Removal of BSUoS charge from Generation
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Ofgem estimates the current shortfall in BSUoS funding to be ~£27/customer based on an April 2023 move to an ex-ante allowance. Using the latest ESO forecast² of BSUoS costs, we estimate the effect of continuing with the current lagged approach once CMP308 has been implemented, even temporarily, would be that the shortfall would increase to ~£38/customer after 6 months, ~£48/customer after 12 months and ~£57/customer after 18 months. **Therefore, even without the approval of CMP361, or equivalent modification, it is essential that the price cap methodology is revised from April 2023 to allow suppliers to be able to pass-through the increase in BSUoS costs resulting from CMP308.**

The allowance should be based on the CMP361 WACM3 tariff, or any revised tariff from a subsequent modification

We welcome Ofgem's approval of CMP361 WACM3 and note that there is likely to be a further code modification in this area in the coming weeks to include more options for an industry BSUoS Fund. If Ofgem subsequently approves a new modification with a different solution to the derivation of the ex-ante tariff or operation of a BSUoS Fund, then the new tariff (or tariffs in the event of a Fund Tariff in addition) can be reflected in the next available quarterly price cap, including any reconciliation adjustment necessary if the new tariff took effect during a price cap period with a different tariff allowance.

The ex-ante BSUoS allowance should be reviewed quarterly with adjustments in a future cap to reflect any differences between allowance and outturn

We agree with the proposal to review the BSUoS allowance quarterly, and also with the proposal to reflect any differences between allowance and outturn in a future cap period should the tariff be reset within a price cap period. This is justified by the volatility and unpredictability of BSUoS costs such that even with a fixed ex-ante tariff with a BSUoS Fund, there can be limited confidence in the tariff not being reset. This would also prevent the need for additional headroom to cover the risk of within-period tariff resets.

We note that Ofgem flags that any such adjustment would need to be consulted upon. Whilst we agree with this, we believe the model should be amended now to include the functionality required for this. This will facilitate a more streamlined consultation process when required, as the consultation would only need to focus on the adjustment value rather than the method of applying it. The change would be simple and would only require an extra set of inputs in tab '3e BSUoS charges', allowing Ofgem to enter and apply any required adjustment on top of the BSUoS Main tariff (and any Fund Tariff), as illustrated below³:

	April 2023 - June 2023	July 2023 - September 2023	October 2023 - December 2023
Period	Q2 2023	Q3 2023	Q4 2023
BSUoS main tariff (£/MWh at transmission system)			
Fund Tariff (£/MWh)			
Adjustment (£/MWh)			

² [ESO Data Portal: Monthly BSUoS Forecast Summary December 2022 - Dataset | National Grid Electricity System Operator \(nationalgrideso.com\)](#)

³ The BSUoS allowance formula would then need to sum all three elements, rather than the first two

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

We agree that replacing the lagged nature of the existing methodology with an ex-ante tariff would mean that BSUoS charges incurred by suppliers in the period January 2022 – March 2023 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 agree 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 allowances 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 mechanism. We have reviewed the transitional adjustment model presented by Ofgem and are comfortable that it appropriately produces an accurate total adjustment to be recovered.

However, as highlighted above, any delay to the move to an ex-ante allowance and commencement of the recovery of the transitional adjustment will exacerbate the supplier shortfall, putting further pressure on suppliers in the current fragile environment and increasing the eventual adjustment required (to £38/customer after 6 months, £48/customer after 12 months and £57/customer after 18 months).

We agree that the costs recovered in CP1 – CP3 should be smeared proportionately across the stage 1 and stage 2 adjustments but can see no justification for treating the costs recovered in CP9 differently. The CP9 costs recovered should also be smeared proportionately across stage 1 and stage 2 instead of being allocated fully to stage 1.

The transitional adjustment should be recovered over 12 months and be included in the Market Stabilisation Charge

Whilst we agree that a twelve-month recovery period strikes an appropriate balance between suppliers and customers, the proposal to apply a two-stage approach in effect creates a 15-month recovery period. We don't believe that waiting for the final three months of actual data is justification for extending the recovery beyond 12 months and believe that the second stage adjustment should be recovered over 9 months so that the full transitional adjustment is recovered over 12 months.

The materiality of the adjustment also creates a volume risk whereby if forward wholesale prices fall below the price cap allowance there is likely to be a significant and swift move away from SVT rates. Therefore, to protect suppliers' recovery of the shortfall we believe the transitional adjustment should also be included in the Market Stabilisation Charge. Including the transitional adjustment in the MSC would be cheaper and fairer than otherwise recovering it via bespoke allowances or EBIT. We will provide further views on these points when we respond to Ofgem's consultation on extending the MSC, and the consultation on the price cap EBIT allowance.

No reduction to the headroom allowance is justified

We agree with the proposal to make no adjustment to the headroom allowance. 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.”

Errors in the Ofgem model

We have identified a potential error in the calculation of the BSUoS allowance in Annex 3. The calculation sums together the ex-ante BSUoS rate and the transitional adjustment and multiplies both by the benchmark typical consumption with a losses uplift. However, the transitional adjustment calculator and the input in Annex 3 present the transitional adjustment as a £/customer amount (at benchmark typical consumption) rather than a £/MWh amount. Therefore, it should only be multiplied by the necessary losses uplift, not by the typical benchmark consumption.

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
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