



Anna Kulhavy
Senior Economist
European Strategy and Environment
Ofgem
9 Millbank
London
SW1P 3GE

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Sent by email to anna.kulhavy@ofgem.gov.uk

Legal & Regulatory

Lakeside West
30 The Causeway
Staines
Middlesex TW18 3BY

Telephone 01784 874 000
Facsimile 01784 878719
www.centrica.com

Dear Anna,

Re: Distributed Energy - Further Proposals for More Flexible Market and Licensing Arrangements - 87/08

Please find attached a non-confidential response on behalf of Centrica plc (excluding Centrica Storage Ltd) in relation to the above joint Ofgem/BERR consultation dated 18 June.

Executive Summary

- **Centrica believes that Distributed Energy can play an important part in tackling the carbon impact of the built environment, particularly when combined with energy efficiency measures.**
- **Centrica believes that there must be a fair and transparent licensing regime in place which is non-discriminatory and allows equal access to all interested participants (i.e. not just existing distributed energy providers).**
- **Ofgem must play its part by thoroughly reviewing the licensing regime (including industry codes) as it relates to DE as part of its Code Governance Review.**
- **Any planning and installation regime must be simple; with no major pre-approval processes in place (which could act as barriers).**

General Comments on Ofgem's initial findings

Centrica supports the Government's commitment to tackling climate change as set out in its recent UK Renewable Energy Strategy consultation paper and we agree that part of that strategy is the efficient development and deployment of Distributed Energy technologies and programmes.

We agree that the complexity of industry codes and market arrangements is a barrier for potential DE developers – and we believe that this is an issue which Ofgem could in part address via its current and ongoing consultation on industry governance. However, the existence of service consolidators reduces the need for DE developers to sign up to existing codes individually and the ability to have a Bilateral Embedded Licence Exemptible Large Power Station Agreement (BELLA) and sell the output directly to a supplier via a PPA also reduces the burden. Whilst we have no evidence to suggest that the costs of licensing for community DE schemes and small suppliers (in relation to complying with

Centrica plc
Registered in England No 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

industry codes) are disproportionate when compared to existing licensed activities, we do agree that the overall licensing regime is complex and this carries a cost to all participants (present and potential).

Ofgem should seize the opportunity to review DE licensing through its current work on Code Governance. We believe that, the creation of two tier licensing or additional licence exemptions is likely to further exacerbate the issues associated with the complexity and efficiency of current industry codes and governance arrangements. We therefore support Ofgem's attempts to review the current industry governance arrangements. However, there are areas of the current arrangements which have much to commend them (for example, the flexibility inherent in the gas governance arrangements which helps manage the administrative burden), and it is essential that these are retained and used to build a strong foundation going forward.

Whilst we agree that the risks and costs of energy imbalance (cash-out) can be high for single source and/or intermittent renewable generators, this is also true for individual suppliers, generators, traders and even for vertically-integrated companies. We do not believe that any party or class of party should receive special treatment in terms of cash-out liability. In addition, DE generators can mitigate by consolidating their output or selling via a PPA (in which cases risk passes to the consolidator/supplier) though this would have a cost, rather than bearing the risk themselves.

We agree that the provision of supplier services, whereby licensed suppliers undertake high-cost, high-competency functions for DE schemes to operate on the public network, is underdeveloped and largely reflects low demand from DE suppliers. However, it is unlikely that anyone would seek to set up such a consolidation operation without a reasonable degree of assurance that the services will be used and paid for at an economic rate – i.e. that they can cover their costs and make a reasonable return.

We recognise that the electricity distribution structure of charges must change to better facilitate DE. To date only one network company has implemented a DE solution and this is restricted to a minority of large consumers.

In relation to Ofgem's consideration as to delivering DE within the price control, Ofgem should consider innovative ways of providing market rules and regulations to pro-actively support DE. It is clear that the existing incentive regime has delivered limited benefits. Any revision to the current incentive regime must only put customer money at stake when Ofgem has evidenced-based certainty that costs will be justified by the benefits of new DE - in terms of reduced network investment, reduced losses and lower carbon emissions. The risk is that, in seeking to accelerate the growth of small scale generation projects, Ofgem may lose sight of ensuring value for money for customers. Any revision to the incentive mechanism must be subject to rigour and be implemented in a transparent manner.

We are pleased that Ofgem has now determined that a common methodology¹ should be in place by April 2010, in parallel with the next price control. We are also pleased that Ofgem is now considering the implementation of a governance framework to manage the development of the common methodology. Adopting such an approach will ensure that commonality is not eroded over time and will enable parties other than network companies to raise changes to the methodology. This latter provision is particularly important to address evolving DE needs.

On the basis that a common methodology is to be developed, we believe that there should now be a moratorium on any interim methodology proposals; this will ensure predictability in this interim period.

In reaching its final decision, it is crucial that Ofgem ensure that the common methodology is not so overly complex that it becomes incomprehensible. The common methodology must balance a number of key principles, these being cost reflectivity against simplicity and predictability; cost reflective signals should be designed in such a way that they are comprehensible to the supplier and generator community whilst allowing the network companies to recover their reasonable costs and in particular for DE recognise any benefit to the network that may arise by connecting DE.

¹ Ofgem decision letter dated 22 July 2008, Ref 104/08.

In terms of the proposals set out in the consultation document, notwithstanding our comments about code governance reform above (and in our responses to the governance consultations), whilst we prefer to avoid the creation of a two tier licensing regime, we could broadly support the concept of an alternative set of more limited conditions as a pragmatic approach for small DE schemes. However, we would wish to be assured that such an approach to licensing would only apply to small scale individual schemes based on clear and objective criteria, specified ex-ante, rather than being a route for larger groupings of small schemes to benefit from reduced obligations. In addition, the interests of consumers must be protected.

In relation to Ofgem's points about highlighting areas for industry to lead (with respect to cash-out reform, reducing the penalty inherent for intermittent generators and small suppliers etc), we must ensure that we do not allow the establishment of unofficial cross-subsidies or discriminatory practices. It is appropriate that intermittent generators should pay cash-out in the same way as other parties, ensuring the real costs associated with system use are properly attributed to all parties. This will incentivise better forecasting tools and lead to a much more efficient network overall. If intermittent generators/small suppliers are not exposed to cash-out in an appropriate way then the result will be increased BSUoS costs.

It is important to recognise the purpose of the cash-out regime – namely to target costs appropriately to those parties who impact the system by being out of balance. As well as avoiding, a two tier licensing regime, we must ensure that a two tier cash-out system is not created, whereby imbalance is deemed more or less “costly” according to the type of underlying generation. This approach would be discriminatory and in the longer term would not be in the best interests of the market.

In addition, the usual assumption is that aggregation/consolidation services would be expected to reduce the possible impacts of intermittent generation on system balance. Whilst this is probably true in most cases, it is also possible that the opposite effect will occur in some cases. If this is the case, these parties should bear their fair share of appropriately targeted costs.

In relation to the rollout and installation of the physical DE kit, we would make the following high level observations:

- Planning and installation must be simple; with no major pre-approval processes in place
- The process for swapping a meter from a one-way to a two-way meter must be simple and practical (and in alignment with the Smart metering rollout)
- There must be simple and low cost 'back-office' industry requirements to support DE

Overall, Centrica is supportive of Ofgem placing DE at the heart of its agenda moving forward, however, Ofgem must also ensure that the framework which is created is fair and transparent to all participants; both existing DE providers and new entrants. Indeed, there must be no unfair commercial advantage to any current or potential parties.

Specific Questions posed in the consultation paper:

Section 1 – Introduction

N/A

Section 2 – Role of licence exemptions

Although we are not specifically invited to comment on the role of licence exemptions at this stage, Centrica believes that the greater the clarity of the Class Exemption Order, the better. We have previously reviewed such orders and found them difficult to interpret. However, we would suggest that any such further development and subsequent clarification be held over until the impacts of the Citiworks case are clear.

Section 3 – Wholesale Market Trading

Question 1: We welcome views on whether the Authority should exercise its power as provided for under the BSC to designate a third party representative with DE interests or expertise to raise BSC code modifications.

There is an existing BSC Panel member who strongly represents the interests of small suppliers and DE generators at the Panel and in terms of engagement with modification processes. We do not believe that a class of parties should receive special or unequal treatment, and that if the demand exists from the DE community for the services that the 'independents' provide, then the votes will be sufficient for them to gain one of the industry representative seats.

It could be foreseen that there would be one representative from DE, one from non-physical traders; one from small suppliers, and so on if Ofgem were to continue along this path. This would be a move away from the concept of independent experts being placed on the BSC Panel and one which we would not support. Our principal belief is that special interest groups (who are also BSC parties or players) should not gain specific advantage in what should be an open and transparent governance process.

Question 2: We welcome expressions of interest from stakeholders interested in having the power to raise code modification proposals on behalf of DE schemes. For those interested parties, please highlight specific reasons why this power should be conferred upon you.

It is in the interests of Suppliers to raise BSC modifications which facilitate a strong PPA market and we would seek to do so where appropriate - in particular where DE schemes have suggested an obstacle that could be removed, or a means of facilitating competition. As suggested above, we do not believe that special treatment needs to be afforded to any class of participant.

Question 3: In terms of the length of designation, we believe that a period in line with the Panel's term (e.g. 2 years) may be a suitable period with which to trial this proposal. We would welcome stakeholders views on the period for which designation might last.

Please see response to Question 2 above.

Question 4: We would welcome views on whether the designated party should be obliged to contribute fees to Elexon in order to participate in the BSC change process. If so, how should the level of contribution be determined?

If a non-BSC party is 'designated', they should fund a reasonable share of the Elexon modification process costs.

There may be value in such funding being an initial payment upon raising the modification – firstly to introduce certainty for the party in terms of cost exposure; and secondly to discourage 'speculative' modifications being raised.

We would also hope that the DE representative would be fully engaged with the modification groups, i.e. the role of a modification proposer carries with it a responsibility to follow the modification through the process; propose analysis, argue for definition and assessment, and so on. In other words, the proposer should not simply be allowed to raise a mod and then simply leave responsibility thereafter to others.

Question 5: Should any other codes be examined in relation to lack of DE representation?

We do not believe so.

Section 4 – Selling to third parties

N/A

Section 5 – Operating as a Supplier on the Licensed Distribution Network

Question 6: We invite stakeholders to identify any good quality information currently available that would be suitable for including in the development of a user friendly information hub on the process of setting up and operating a DE scheme.

Question 7: Do you agree with the proposed license amendment to SLC 11.2 (see Appendix 2)? Suppliers - please indicate whether you would accept the proposed license amendment.

It looks acceptable as currently drafted; however, we would wish to see Ofgem's final drafting proposals before we could commit to accepting any licence change.

Question 8: Should Ofgem issue guidance on eligibility criteria for switching off the code compliance licence condition? If so, what should the main criteria be?

Yes.

Question 9: Should Ofgem establish an industry working group to develop a good practice guide on supplier services agreements?

Yes, although we would wish to develop this idea further before forming any further view.

Question 10: How should the risks of a breakdown in the DE-Agent relationship be mitigated?

We do not believe that this is a regulatory matter; but rather a simple contractual issue between two commercially competent parties. Therefore, any breakdown in relationship between a DE Provider and an Agent would simply follow the same path of recourse and remedies as any other commercially negotiated agreement.

Section 6 – Conclusions and Way Forward

We believe that your Forward Work Plan looks achievable and look forward to giving our continued support to the DE Working Group.

I trust that you will find the above helpful and self-explanatory, however, if you require clarification on any part of our response, please feel free to contact me on 07979 566319 or at nigel.howard@centrica.com

Yours sincerely,



Nigel Howard
Senior Regulatory Manager