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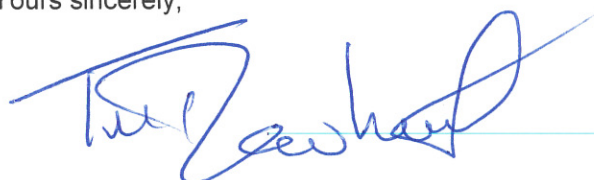
Dear Nick,

**Charges for pre-2005 Distributed Generators' use of DNOs' distribution systems: response to Chapter 3 issues**

1. We welcome the publication of this consultation on compensation principles. We have been very keen for Ofgem to address the issue of compensation ever since proposals to apply ongoing charges to pre-2005 connected distributed generators were first proposed by the DNOs. This is the Centrica response to Chapter 3 of this consultation, and is not confidential.
2. We have five large embedded generation stations affected by these proposals (at Barry, Brigg, King's Lynn, Peterborough and Roosecote). Each of these stations connected to their respective distribution networks prior to 2005, and paid large upfront fees to:
  - connect and use the network;
  - facilitate the operation and maintenance (O&M) of DNO owned assets; and
  - have the right to export power onto the distribution network up to a specific maximum export capacity (in accordance with our connection and use of system agreements).
3. Contracts were put in place for each of these stations at the time that clearly set out the extent of these rights. None of these contracts make provision for further charges. The expectation at the time of contract agreement was that the charges paid at connection were in lieu of any ongoing use of system payments. The payments made at connection therefore represented a "deep connection charge" (covering the costs of exporting power from each station for the duration of each contract). This was, after all, the prevailing policy put in place by OFGEM, and before that OFFER, at the time the stations connected.
4. Without full compensation, the application of charges to these affected generation stations would directly conflict with our contractual rights. Were Ofgem to insist on these charges being applied without appropriate compensation being agreed, this would constitute a material increase in regulatory risk, potentially having a damaging effect on investment in new generation (and subsequently on security of supply). Furthermore, increasing regulatory uncertainty for investment in generation would also seem to run counter to the government's policy of encouraging new generation as fundamental part of its climate change commitments.
5. We will be responding to the consultation in full early next month. However, you asked for early views from respondents on the questions posed in Chapter 3 of the document. In particular, whether we agree with your minded-to position to adopt an "unbundled" approach to the agreement of compensation and of charges.

6. We believe there are strong reasons for adopting a “bundled” approach to compensation and ongoing charges. A bundled approach would ensure due recognition of the importance of recompense for contractual rights of pre-2005 connected generators in the work to introduce charges by 1 April 2011. This is appropriate given the role of those rights in the original decisions to fund the relevant investments. It would be the approach that had least impact in terms of stakeholder regulatory risk (being an explicit recognition that contractual rights would be fully respected). As a practical matter it would also ensure that charges/compensation were not “de-coupled” in process.
7. However, we also recognise that the bundled approach might be complex to develop and implement, particularly given the constrained timescales we understand that the EDCM are working to. It is also unclear how compensation rules would change over time as charging methodologies evolve (and whether governance for both compensation and charges would be the same).
8. Most importantly, however, we believe contractual rights can still be fully respected so long as Ofgem provides explicit written assurance that pre-2005 connected generators that have contractual rights to export power onto their networks will not be required to pay any new ongoing charges until compensation for each affected generation station has been agreed in a manner that is consistent with those rights and their value to us. So long as this assurance is clearly provided, then we are happy for development of use of system charges and compensation to be “unbundled”.
9. While this is the case, it is also important to note that our continued engagement in work on refining the charges that are expected to apply from April 2011 should not be interpreted in any way as prejudicing our views on appropriate levels of compensation (or the timing of compensation payments).
10. I hope that this response has been useful in setting out our views on the issues raised in Chapter 3, and has made our favoured next steps clear. Please contact me if you would like discuss any of the issues covered in this response in more detail.

Yours sincerely,



Tim Dewhurst

Head of Network Regulation and Market Design  
**British Gas**