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Ofgem
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5th December 2011,

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Dear Guy,

Consultation on Distribution Use of System Charging: Way Forward on Higher Voltage Generation Charging

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

We maintain our view that the LRIC methodology for generation does not provide cost reflective charges for large embedded power stations where networks have been specifically sized to meet their export requirements. A number of measures have been introduced to mitigate this impact. However the fundamental issues have not been addressed and we are concerned as to whether the level of charges for some of our generators can be justified.

Use of system charges can provide appropriate locational cost signals but it is vital that the charges are truly cost reflective and predictable over the longer term. Unfortunately, the current proposals for EDCM generation charges do not deliver cost reflective or predictable charges and will not provide an appropriate signal to generators. We are therefore not supportive of any option that proposes to maintain the locational charge element of the proposed EDCM for generators.

Of the options Ofgem put forward in the consultation, we are most supportive of option 2 although we have suggested a slight improvement on this in our response to question 2.8 which proposes a more site specific reinforcement cost allocation which we believe improves the cost reflectivity and predictability of this option.

We also have concerns over the potential cross subsidising effects of options 3 and 4. Demand users are already paying for CDCM generation credits and will also be paying for EDCM generation credits when they are implemented. It would not seem appropriate to us to also recover generation incentive revenue from demand customers.

We agree with Ofgem's inclination with regards to option 5 – a more fundamental revisit of the methodology. Given the industry resource requirements that this would require, the further delay in arriving at an enduring solution, and the uncertainty such a decision would bring, we would prefer other options for removing the flaws inherent in the current EDCM proposals.

More detailed answers to your questions follow. I trust this response will be helpful to you in setting out our views. Please contact me if you would like to discuss any of the issues covered in this response in more detail.

Yours faithfully,

Andy Manning
Head of Transmission & Distribution - 07789 575 553

CHAPTER: Two

Option-specific

Question 2.1: Option 1 – Do you think that charges more or less appropriately reflect costs imposed by DG, following the removal of (some or all) pre-2005 DG?

We remain of the view that the locational aspect of the current EDCM proposal for generation charging under the LRIC methodology does not provide cost reflective charging for large embedded power stations where networks have been specifically sized to meet their export requirements. Therefore whilst the overall pot size may be appropriate to the group of customers it is being applied to, we do not believe that it follows under this option that individual generator charges will more or less appropriately reflect costs imposed by DG.

Question 2.2: Option 2 – Do you think it is appropriate to include a generation-led reinforcement (locational) charge? What are the advantages and disadvantages of removing such a charge?

We believe that the flaws inherent in the current proposed methodology for EDCM generation charges make it inappropriate to include a generation-led reinforcement (locational) charge and therefore we are supportive of the proposal within option 2 to remove this element from the EDCM. The advantages of this approach are captured by Ofgem's assessment in table 2.2 and we would note that the disadvantages in this table only hold on the assumption that the method of calculating the locational charge is not flawed.

Question 2.3: Option 2 – This option may result in increased charges for generators currently in demand-dominated areas of the network, compared to those predicted under the EDCM. However, this could be matched by a decrease in potential volatility. What are your views on this potential trade off?

Comparing against charges derived from a flawed methodology is not appropriate. In our view the removal of the locational charge element of the methodology and a decrease in volatility represents a win-win outcome rather than a trade off. Furthermore, generators in demand-dominated areas of the network will still be likely to receive locational credits under option 2 and will therefore remain in a more favorable position compared to those in generation dominated areas.

Question 2.4: Option 3 – Do you think that the EDCM should continue to calculate charges as if all generators continue to be charged? What is the reasoning behind your response?

This option represents an intentional decision to cross subsidise generation charges at the expense of demand customers and should not be taken forward.

Question 2.5: Option 4 – Is it appropriate for EDCM generators to recover their share (based on their capacity relative to CDCM) of the DG incentive revenue (ie 80 per cent of generation-led reinforcement costs plus £1/kW incentive revenue)? If not, how should this incentive revenue be recovered?

It is appropriate for EDCM generators to recover their share of the DG incentive revenue (rather than it being paid for by demand customers). Demand customers will pay for the credits received by EDCM generators in the same way they are currently paying for the

credits received by CDCM generators and will therefore be making a full contribution to the benefits brought about by increased generation. It would therefore be inappropriate to also expect demand customers to pay for the DG incentive revenue.

Question 2.6: Option 5 – Do you think it is better to revisit the methodology more fundamentally?

Given the industry resource requirements that this would require, the further delay in arriving at an enduring solution, and the uncertainty such a decision would bring, we are in favour of other options for removing the flaws inherent in the current EDCM proposals.

Question 2.7: Option 5 – What cost signals do you think generators have the ability to respond to?

The connection charge provides a strong locational signal that generators can respond to. Use of system charges can also provide an appropriate locational cost signal but it is vital that the charges are truly cost reflective and predictable over the longer term. Unfortunately, the current proposals for EDCM generation charges do not deliver cost reflective or predictable charges and will not provide an appropriate signal to generators.

We believe that the main signal that generators are likely respond to which results from the proposed changes, is one that has the opposite effect to that intended. The intention is to have a signal that encourages embedded generation to locate on the network in areas that have more demand than generation therefore reducing the need for network reinforcement. Unfortunately for large embedded generation (greater than 100MW i.e. a BMU) they could potentially end up paying both GDUoS and TNUoS charges. Therefore the signal given is to drive investment onto the transmission network in preference to the distribution network, as there is more certainty in charges over the life of the investment.

The suggestion in 2.2 to remove the locational element would help to mitigate what we believe is an unintended signal.

General questions

Question 2.8: Do you have any other suggested modifications to the proposed methodology?

We believe another option that is worthy of consideration is a development on option 2. The pot would remain as per option 2 but instead of charging the same rate to all non-exempt generators, we would propose that generators are charged on a more site specific basis where the charge for each generator is set to recover 80% of the annuitised actual DNO funded reinforcement costs associated with its own connection plus the £1/kW incentive (post -2005 only) plus the £1/kW allowance for O&M. Sole Use Asset charges would remain as per option 2 and scaling would apply uniformly to ensure that the generators as a group pay the appropriate amount. We note that this method is similar to some already in existence and provides more cost reflective charges than other options considered in the consultation which smear the 80% of the actual reinforcement costs across all generators. We would combine the above with the current proposals for EDCM credits.

Question 2.9: Which of the options (if any, or including a combination) do you think would enable the EDCM for DG charging to fulfil the Relevant Objectives set out in the licence after the removal of exempt generators? Why?

Option 1, due to its continued reliance on a flawed LRIC methodology for calculating locational charges will not be cost reflective and due to the likely volatility of charges will not support competition in the generation of electricity.

Option 2 is an improvement on option one and could feasibly fulfill the relevant objectives. Removing the flawed elements of the methodology will improve predictability and maintaining generation credits will provide strong locational signals.

Option 3 involves a conscious decision to cross subsidise and can not fulfill the objectives.

Option 4 also involves a potential cross subsidy since demand customers will be liable for the differential between the actual reinforcement costs and the DG incentive revenue as well as paying for generation credits (EDCM and CDCM).

We believe our proposed option is an improvement on the above options as it has the benefits associated with option 2 (predictability, removal of flawed elements) and is more cost reflective since it focuses any actual reinforcement costs onto the generators that have caused them instead of smearing them across all generators.

Question 2.10: What is the most appropriate way of redistributing the unrecovered revenue from exempted generators to other users of the network?

Since these generators are exempt from charges, there should not be any unrecovered revenue associated with them. We do not support redistribution on unrecovered revenue as this represents a cross subsidy.

CHAPTER: Three

Question 3.1: Do you think EDCM charges for non-exempted generators should apply from 1 April 2013? Why?

We are comfortable with charges applying from April 2013 provided sufficient notice of the level of charges for each site is provided to customers and suppliers.

Question 3.2: Do you agree that the boundary change for generators should be deferred to coincide with the implementation of EDCM generator charging? Why?

Whilst this represents quite a messy implementation of the boundary change, it would seem to us to be appropriate in the current circumstances.

Question 3.3: Do you have any comments on the suggested timetable for the reconsideration and subsequent approval of EDCM charges for DG?

We believe the final decision by Ofgem should be made by the end of August to provide sufficient notice to impacted parties.