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7th August 2014

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Dear Kersti,

Consultation on CUSC modification proposal 224

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

We believe the updated ACER guidance published in April 2014 (Opinion of the agency for the co-operation of energy regulators No. 09/2014) makes this modification unnecessary and incapable of approval. It would appear to have been easier for this modification to have been withdrawn in the light of the updated guidance, although we recognise there may be procedural reasons for this.

In any case we do not believe it would have been in the interests of GB consumers for Ofgem to have approved this modification because:

- Given the negative impact of this change on GB consumers we consider that Ofgem's principal objective and statutory duties are best served by taking the broader legal view of Paragraph 2(1) of Annex B of Regulation No 838/2010.
- The transfer of costs from generators to demand is likely to be significantly greater than shown by the impact assessment.
- We do not believe CMP 224 has been demonstrated to better meet the CUSC objectives.

Updated ACER guidance

The defect that this modification seeks to address is described in the modification report as:

under forecast conditions, the charges arising from GB charging arrangements are expected to exceed the range in the current EC Regulation of € zero to €2.5 /MWh for the annual average generation transmission charges in GB within the next few years (charging year 2015/16 in a worst case scenario)

However, the updated ACER guidance states:

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- *Different levels of power-based G-charges (€/MW) or of lump-sum G-charges, as long as they reflect the costs of providing transmission infrastructure services to generators, can be used to give appropriate and harmonized locational signals for efficient investments in generation, e.g. to promote locations close to load centers or where the existing grid can accommodate the additional generation capacity with no or minimal additional investments.*
- *The Agency therefore considers it **unnecessary to propose restrictions on cost reflective power-based G-charges** and on lump-sum G-charges.*

This removes the range that was potentially going to be exceeded and so there is no longer a defect to be addressed and the modification is unnecessary.

The legal drafting for all of the various options contain the term Cap_{EC} , defined as:

Cap_{EC} = Upper limit of the range specified by European Commission Regulation 838/2010 Part B paragraph 3 (or any subsequent regulation specifying such a limit) on annual average transmission charge payable by generation

As there is no longer a specified range this term is rendered meaningless and without a value. It further follows that the other terms (the proportion of revenue to be paid by generators) using Cap_{EC} are not capable of being calculated and so this modification is not workable under the revised ACER guidance. We recognise that the guidance is yet to be adopted but is highly likely to be so. It would not be sensible to approve a modification that is highly likely to be unnecessary and require a further modification to reverse.

Interpretation of Paragraph 2(1) of Annex B of the Regulation

We agree that the interpretation of Paragraph 2(1) of Annex B of Regulation No 838/2010 is ambiguous. However, whilst the evidence in respect of potential consumer impact contained in the modification report is limited, we agree with Ofgem's view that there would be a negative impact for consumers in the short term due to the lack of time for users to react to the charging changes and this would mean that increases in demand charges would be passed on to consumers more quickly and more completely than reductions in generation charges.

It is unclear how quickly and completely changes in TNUoS for generators would be reflected in power price. The ACER guidance notes in Section 3.1.3:

In markets with a high level of competition, power-based G-charges have no effect on the dispatch of power plants, as they do not increase the generation costs of the generators and hence SRMC are unchanged.

Therefore given the negative impact of this change on GB consumers we consider that regardless of which legal interpretation Ofgem may view as more persuasive, if it believes that it is legally defensible to exclude local charges for the purposes of the regulation then it should do so to protect the interests of consumers.

Transfer of costs from Generation to Demand

We believe the impact assessment provided in the modification report and referenced in Ofgem's consultation is not robust since it appears to us to exclude any allowance for the significant revenue allowances that will begin to be added to TNUoS charges through the application of the RIIO T1 uncertainty mechanisms, especially as a result of the funding requirements of Strategic Wider Works. It is important that the impact assessment reflects a best view of the likely impact of the change or at least clearly states its assumptions so that users may attempt to form their own view of the real impact.

At RIIO T1 Final Proposals Ofgem presented two revenue scenarios – a Baseline view, which excluded the impact of the RIIO T1 uncertainty mechanisms and a Best View, which included the impact of the uncertainty mechanisms. For 2015/16 alone the difference between the two scenarios is over £300m and it increases in later years. We note that some strategic wider works projects have already been approved, and others are on the path to approval - for instance Ofgem have recently approved the Needs Case for the Caithness Moray Strategic Wider Work which will add c. £1.2bn to expenditure during RIIO T1 and for which Ofgem are considering whether to allow SHE Transmission to start recovering the revenues in 2015/16.

A simple analysis of the figures presented in the consultation suggests that no allowance has been included for the RIIO T1 Uncertainty Mechanism funding and we estimate that the analysis presented could therefore understate the impact on Demand by c. £1bn over the period.

We do not believe CMP 224 has been demonstrated to better meets the CUSC objectives

Our opinions of the various modification proposals are unchanged since the Code Administrator Consultation (and so assess the modification without considering the impact of the revised ACER guidance covered above):

All modification proposals:

Objective (b): we have not identified an impact on objective (b) for any of the options

Objective (c): by including a bandwidth we consider that all of the options do not better facilitate objective (c) since any bandwidth will go above and beyond the developments in the transmission business and so not 'properly' take account of developments. Clearly if the charges should not be above €2.50/MWh then targeting either €2.34/MWh or €2.15/MWh is inappropriate.

Objective (d): All proposals seem to better facilitate objective (d) by attempting to comply with the European Regulation.

With regards to objective (a) we have differing opinions on whether each of the proposals better facilitates this objective:

Original:

Objective (a): We do not consider that the original proposal better meets CUSC objective (a) since the short notice of implementation will create windfall winners and losers. This is especially the case since the impact assessment appears to exclude any revenue allowances associated with the RIIO T1

uncertainty mechanisms without clearly setting this assumption out. This means parties are less likely to have been able to calculate the real impact of the change themselves. We estimate that the impact on demand revenues could be c. £1bn higher, over the period, than shown in the impact assessment.

WACM1:

Objective (a): We do not consider that the WACM1 proposal better meets CUSC objective (a) since the short notice of implementation will create windfall winners and losers. These windfalls or losses are likely to be even higher than for the original due to the increased bandwidth proposed for this option.

WACM2:

Objective (a): We cannot conclude whether there will be windfall winners or losers associated with WACM2 as the impact assessment does not appear to include revenues associated with uncertainty mechanisms. However if, under a more robust TNUoS revenue scenario, there is no impact on the proportion of revenue recovered from demand and generation for the next few years then this proposal would have a neutral impact on competition.

WACM3:

Objective (a): We cannot conclude there will be windfall winners or losers associated with WACM3 as the impact assessment does not appear to include revenues associated with uncertainty mechanisms. However if, under a more robust TNUoS revenue scenario, there is no impact on the proportion of revenue recovered from demand and generation for the next few years then this proposal could have a beneficial impact on competition by providing more certainty of the revenue split further in advance.

Overall assessment against the objectives:

Overall, we are unable to conclude whether any of the options better meet the objectives. We understand that the proposal is seeking to change only the current arrangements to the extent that satisfies the Regulation. To achieve this Ofgem would need, first of all, to come to a definitive legal conclusion on whether local charges can be excluded for the purposes of the regulation. Once this conclusive legal opinion has been provided, then an option which does not include any bandwidth should be developed – for example an alternative approach to bandwidth would be to create separate over/under recoveries for demand and generation so that if in any year the forecast assumptions used to set charges were incorrect, then there would be a corresponding adjustment to the following years tariffs to maintain the cap over time.

In summary, we do not believe this modification is in the interests of GB consumers in any case but is not necessary, or workable, in light of the revised ACER guidance. We hope you find our comments helpful. Please do not hesitate to contact me if you have any questions.

Yours sincerely,

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