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18 April 2017

Via email

Dear Andrew

Re: Minded to decision and draft Impact Assessment of industry's proposals (CMP264 and CMP265) to change electricity transmission charging arrangements for Embedded Generators

Thank you for the opportunity to respond to your consultation. This is a **non-confidential** response on behalf of the Centrica group of companies excluding Centrica Storage.

We have previously set out why the effective receipt by exemptible embedded generation (EG) of the TNUoS Demand Residual (TDR) tariff is not cost reflective¹. In this response, we focus on our preferred reform options, taking into account the cost reflectivity and competition points we have already made and the views Ofgem has since set out².

Preferred reform options

We note Ofgem is minded to approve WACM 4 from 2018/19 and considers that WACMs 3 and 5 are the next best options available.

In our view, the chosen reform option must:

1. Lead to broadly cost reflective TNUoS tariffs for exemptible embedded generation (EG), thereby ensuring effective competition between EG and licensable and transmission connected generation (TG);
2. Be subject to phased or delayed implementation (but not grandfathering), to mitigate impacts on investor confidence of unduly abrupt change.

¹ See [our response to your July 2016 open letter](#) and the [CMP264/5 industry consultations](#)

² In its [December 2016 update](#) and the ["minded to" decision on CMP264/5](#)

We therefore believe **WACMs 2, 4 and 5 are the best reform options available**. We also believe WACMs 2, 4 and 5 best meet the requirements of the CUSC, the Transmission Company's Licence and the statutes governing Ofgem.

The possibility that WACM 3 could be implemented in 2018/19 without phasing renders it unsuitable on investor confidence grounds. We acknowledge that WACM 3 (and indeed WACM 1) could in principle be implemented a few years from now to mitigate impacts on investor confidence, but since Ofgem has expressed reservations with this approach, we assume WACMs featuring phasing are the only way to address issues of investor confidence without resorting to grandfathering. Options featuring grandfathering (WACMs 12-23) are unsuitable as they grant an excessive level of protection to existing EG and excessively diminish the cost reflectivity and competitive benefits of reform, particularly in the medium term. WACMs 6-11 are unsuitable because they give enduring competitive advantage to EG over TG for no underlying cost reason.

We note that, even with the three year phasing of WACMs 2, 4 and 5, EG players who secured Capacity Market (CM) agreements in 2015 (and may not commission until 2019) will in practice get little mitigation from phasing, as the value of their "Embedded Export Tariff" will already have dropped to ~£16/kW by 2019/20, before reaching the enduring level in 2020/21. We therefore believe **Ofgem should delay implementation of WACM 2, 4 or 5 to 2019/20** (rather than 2018/19 as currently envisaged). This would give appropriate recognition to the four-year-ahead price commitment required by the CM and the need to maintain investor confidence - without impairing the ultimate need for (greater) cost reflectivity in a reasonable timeframe.

Wider views on stimulating flexibility in a "post reform" environment

The effective receipt by EG of the TNUoS Demand Residual (TDR) tariff is viewed by some stakeholders as a "proxy payment" for flexibility, and has in practice helped bring on flexible generating plant in GB. Whilst we accept that TNUoS charges are the wrong mechanism for rewarding flexibility, we do believe regulatory efforts are needed to ensure tenders for flexibility services – particularly at distribution level – are given sufficient priority going forward. There is no clear evidence that alternatives to traditional network reinforcement are given meaningful consideration by network companies in all cases. Ofgem should therefore examine whether measures are needed to ensure procurement of flexibility services is given proper consideration by network companies going forward.

Responses to specific consultation questions

Our responses to your specific consultation questions can be found in Annex 1 below. Please contact me if you would like to discuss any aspect of our response.

Yours sincerely,

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Annex 1 – Responses to specific consultation questions

Question 1: Do you agree with our problem definition and that the Transmission Network Use of System (TNUoS) Demand Residual (TDR) payments to sub-100MW Embedded Generation (“smaller EG”) are distorting dispatch, wholesale price, the capacity market (CM) and that they pose an increased cost to consumers?

Yes.

Question 2: Do you agree that rising TDR payments to smaller EG is a problem which needs to be addressed?

Yes.

Question 3: Do you agree with our interpretation of the applicable CUSC objectives?

Yes.

Question 4: Do you agree with our assessment against the applicable CUSC objectives and statutory duties? Please provide evidence for any differing views.

We agree with the majority of Ofgem’s assessment of the WACMs against the applicable CUSC objectives and Ofgem’s statutory duties.

However we disagree with Ofgem’s assessment that the competition benefits of WACMs that include the TNUoS Generation Residual (TGR) in the value of “x” are no greater than WACMs that exclude the TGR from the value of “x”.

Effective competition in generation is most likely if EG and TG face equivalent residual tariffs. The TGR is forecast to be a credit from 2017/18 onwards. If EG does not receive the TGR, there is a risk that future investment decisions will be biased in favour of TG for reasons unrelated to cost. In effect, exclusion of EG from the TGR creates the opposite of the problem we have today with EG receiving the TDR (albeit on a much smaller scale).

Ofgem suggests in paras 4.10 to 4.13 that if the TGR became a charge in future (as opposed to a credit, which it is forecast to be from 2017/18 onwards), the presence of a zero tariff floor in WACMs 1,2 and 5³ would prevent EG “facing positive transmission charges when they generate at peak”. Whilst this is true, the criticism pertains to the zero tariff floor, not the fact that the TGR is included in the value of “x”. If the TGR reverted to a charge in future, the competitive disadvantage to TG would be the same (and in some cases higher) under Ofgem’s preferred WACM 4 as it would be under WACMs 1, 2 and 5.

In summary, if the TGR becomes a charge in future, all WACMs with a zero tariff floor have the potential to give undue competitive advantage to EG versus TG. However, in circumstances where the TGR represents a credit, WACMs that include the TGR in the value of “x” deliver competitive benefits over and above WACMs that exclude the TGR from the value of “x”. We therefore disagree with Ofgem’s conclusion that there is no difference to

³ We disregard WACMs 12,14 and 20 in this discussion because we don’t consider them to be plausible reform options.

competition between WACMs that include the TGR in the value of “x” and WACMs that exclude it. WACMs that include the TGR in the value of “x” are better from a competition standpoint.

Question 5: In our assessment against the objectives, do you believe there are any relevant assessments we have not taken into account?

No.

Question 6: Do you agree with our assessment that, in this instance, grandfathering as set out in the WACMs would be unlikely to best facilitate the CUSC objectives when compared to the other options available to us?

We agree that grandfathering as set out in the WACMs is unlikely to best facilitate the CUSC objectives compared to options that do not feature grandfathering. We have concerns about grandfathering on competitive, cost reflectivity and administrative complexity grounds. As set out in our cover letter, the impacts of reform on investor confidence should be addressed through phasing and/or delayed implementation of reform, not grandfathering.

Question 7: Do you agree with our assessment that the value of the avoided GSP investment cost best facilitates the applicable CUSC objectives?

We do not think the argument that EG is associated with avoided GSP investment is overwhelming. For example, we question whether EG located behind an exporting GSP can really be viewed as delivering GSP cost savings. However, we acknowledge there are likely to be cases where GSP savings arising from EG are genuine. We can therefore see a case for the value of “x” including a modest credit to reflect deemed GSP cost savings.

Question 8: Do you agree with our assessment of the impacts on security of supply? Please provide evidence for provided views.

We broadly agree with Ofgem’s security of supply assessment, albeit we believe the security of supply benefits of phasing and/or delayed implementation may be greater than “marginal”, as Ofgem suggests.

Question 9: Please provide evidence to show if there are other cost savings which small EG drive in comparison to larger (over 100MW) EG on the distribution system.

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Question 10: Is there other evidence that payment above avoided GSP/generation residual would better facilitate the applicable objectives?

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Question 11: Do you believe you have a legitimate expectation or contractual right for the continuation of TDR payments? If so, please provide evidence.

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Question 12: Do you agree with our assessment of the distributional issues?

-

Question 13: Are there any sectors that we may have overlooked?

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Question 14: Do you agree with our modelling approach?

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Question 15: Do you think that our background assumptions and using FES data is an appropriate approximation for status quo?

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Question 16: Where WACMs are not modelled directly, do you think our assessment is appropriate (see appendix 8 for detail)?

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Question 17: Of the options available to us, do you agree that WACM4 best facilitates the applicable CUSC objectives?

We believe WACM 4 is **among** the best options for facilitating the CUSC objectives because:

- It leads to broadly cost reflective TNUoS tariffs for exemptible embedded generation (EG), which by definition furthers the CUSC objective of cost reflectivity.
- It leads to far greater equivalence in TNUoS tariffs between EG and licensable and transmission connected generation (TG), thereby furthering the CUSC objective of effective competition.
- It features phased implementation, which appropriately mitigates the negative perceptions of the GB regulatory regime that could arise in scenarios of abrupt implementation. The beneficial effect on investor perceptions from phasing will maintain a broader base of investors in the GB power sector than might otherwise be the case and ensure a continued competitive supply of finance to the sector. This should facilitate the CUSC objective of effective competition⁴.

We recognise the effects of the various WACMs on the CUSC objectives may sometimes be in conflict and weighing up the relative merits is not always straightforward. However, as stated

⁴ As per our cover letter, we believe phased and/or delayed implementation is the appropriate way to address issues of investor confidence. Grandfathering of what are supposed to be cost reflective transmission tariffs would give excessive protection to existing EG investors and would ultimately be worse for effective competition than phasing and/or delayed implementation of reform.

in our cover letter, we believe WACMs featuring grandfathering (WACMs 12-23) are unsuitable as they grant an excessive level of protection to existing EG and excessively diminish the cost reflectivity and competitive benefits of reform, particularly in the medium term. We also believe WACMs 6-11 are unsuitable because they give enduring competitive advantage to EG over TG for no underlying cost reason.

Overall, we believe **WACMs 2, 4 and 5 are the best reform options available and best meet the CUSC objectives**. Of these, we believe WACMs 2 and 5 are slightly better than WACM 4 for effective competition, as including the TNUoS Generation Residual (TGR) in the “value of x” will give greater equivalence in TNUoS tariffs between EG and TG. We accept that WACM 4 could be viewed as more cost reflective as WACMs 2 and 5, as the “value of x” is comprised wholly of a tariff intended to represent avoided costs.