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Sent by email to: TCR@Ofgem.gov.uk

Dear Andy,

Re: Future Charging and Access programme – consultation on refined residual charging banding in the Targeted Charging Review

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

We are supportive of the intent behind Ofgem's refined residual charge proposal to take more account of the diversity of non-domestic users. However, the proposed banding approach creates significant practical difficulties for industry and the boundaries introduced are themselves likely to cause harmful distortions. As a result, we continue to believe that a more appropriate approach for recovery of the demand residual is:

- **A net kWh approach to residual allocation to segments (DUoS tariff groups)**
- **A capacity charge approach to residual recovery for larger CT-metered users**
- **A fixed charge approach to residual recovery for smaller WC-metered users**

The diversity of non-domestic users:

In our response to Ofgem's minded-to decision on the Targeted Charging Review we raised concerns surrounding the fairness of the distributional impact of Ofgem's preferred approach (net kWh allocation with a fixed charge recovery). We highlighted that user characteristics within segments can vary significantly, and that this will be particularly apparent for larger users (CT metered i.e. measurement classes C & E). We provided evidence of the effect on the smaller customers in some of these segments. For instance, over 20% of our LV HH portfolio (CT-metered) have an agreed capacity of less than 50kVA, yet we estimated they would pay c. £3000/yr more in residual cost under Ofgem's preferred approach compared to equivalent customers who were WC metered. Due to their small demand, these customers could simply change their meter to WC to switch segments, reducing their costs significantly – providing an

incentive that is not economically justified. This incentive also applied to customers of similar size connected at different voltage levels e.g. a smaller HV connected customer could reduce charges by c. £35k/yr by disconnecting their HV connection and paying for an LV connection instead.

For these reasons, we are supportive of the intent behind Ofgem's refined residual charge proposal to take more account of the diversity of non-domestic users. However, whilst the new option scores better on the TCR principle of **fairness**, we consider it scores less well on the TCR principles of **practicality and proportionality** and **reducing harmful distortions**.

Practicality and proportionality:

The proposed bands are not currently supported by industry data arrangements. For example, it would not be feasible under current arrangements for DNOs and the ESO to set charges and invoice in accordance with these new bands as they do not have access to the required data set. Of course, industry data arrangements could be changed to allow this data to be made available however this could be a significant practical implementation task.

It will also be difficult for suppliers to price customers ahead of knowing which band they reside in. The large differences in residual costs in each band creates a significant new risk for suppliers which could ultimately lead to higher costs for customers. The proposal to reset the band boundaries at each price control will mean this will be an enduring risk rather than simply a one-off risk at implementation. This will also lead to enduring disturbance to many ordinary customers who, despite taking no action to avoid residual, could face significant increases in charges simply because they find themselves the wrong side of a new boundary. For example, a HV customer with an agreed capacity of 2,500 kVA, the upper end of a boundary in the illustrative example set out in the consultation, could initially pay c. £80k/yr in residual costs under the new option. However, if the periodic resetting of the boundary changes the upper end to 2,400 kVA, and the customer finds themselves in the next higher band, their new residual cost could increase to c. £200k/yr. We do not think this level of enduring disturbance to ordinary customers represents a proportionate solution for ensuring all customers pay a 'fair share' of residual costs, particularly when a customer's 'fair share' can change so dramatically.

We also note that Ofgem *expect that some form of revenue reconciliation is likely to be needed*. A residual cost methodology that involves retrospective adjustment at a customer level will lead to another new and significant risk to suppliers which will ultimately add to consumer costs. Again, we do not believe this is a proportionate or practical approach. Charging methodologies which are predictable and transparent are likely to facilitate lower overall consumer costs and so we recommend the residual charges are set on an ex-ante basis only. This means any resulting over- or under-recovery of allowed revenue would be treated at an aggregate level and so would feed into the correction factor in the normal way (to be recovered from ex-ante charges in a subsequent charging year).

Harmful distortions associated with Ofgem's refined proposal:

Whilst we appreciate the intent behind Ofgem's refined proposal, it will create boundaries where network charges are significantly different either side of the boundary. This creates a strong and distortive signal for customers on the wrong side of the boundary. Ofgem correctly identify that there are a number of factors which would limit users' ability or willingness to reduce their agreed capacity in practice – such as the large cost of building on-site capacity capable of providing the same level of system security as the grid, and the ability to re-gain network capacity once it had

been handed back. However, the new boundaries create cliff edges where the 'prize' for a small reduction in agreed capacity is so large that it is likely to distort the behaviour of individual customers, despite these practical difficulties.

Ofgem have identified the risk associated with charging boundaries in their Access and Forward Looking Charging SCR and so it seems inconsistent with the direction of travel in that SCR to introduce boundaries for residual recovery.

Centrica Proposal for Residual Recovery:

We continue to consider that a more appropriate approach for residual recovery is a hybrid of Ofgem's two leading options from the minded-to decision:

- A net kWh approach to **residual allocation** to segments (DUoS tariff groups)
- A fixed charge approach to **residual recovery** for smaller WC-metered customers (i.e. Measurement classes A, F & G)
- A capacity charge approach to **residual recovery** for larger CT-metered customers (i.e. Measurement classes C & E)

Our proposed hybrid approach is an improvement on Ofgem's preferred option from the minded-to decision. The use of agreed capacity to segment larger users delivers the improvement in equitability sought by Ofgem's new option but does not suffer from the same degree of boundary effects created by the revised proposal. Therefore, we believe it is much less likely to create incentives that outweigh the practical difficulties associated with reductions in agreed capacity.

Since our proposed approach maintains a net volume allocation/fixed charge recovery for smaller customers, it also avoids the problems associated with deeming capacity inherent in Ofgem's other leading option from the minded-to decision, which we highlighted in our response to that consultation.

I hope you find these comments helpful. Please contact me if you would like to discuss any aspect of our response.

Yours sincerely,

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