Our Ref: RW/ls

27th August 2004

Mr Mark Cox
Ofgem
9 Millbank
London

Dear Mark

RE: ELECTRICITY DISTRIBUTION CONNECTION AND USE OF SYSTEM CHARGES FOR DEMAND CUSTOMERS AND GENERATORS – IPNL RESPONSE

IPNL sets out below and in the Annex its response to the above consultation. For ease of reference we have reproduced in bold those items of Ofgem's consultation papers upon which we wish to comment and have put our response in italics underneath. Not all headings have been reproduced – indicating that, at this stage, we think that the problems/issues raised by those headings cannot be resolved until resolution is reached on the other items for which we have provided a response.

General Points

Overall the consultation does not add value because there is insufficient information in the annexes to take an informed view as to appropriateness of the models.

It is clear however that a common methodology must be adopted which reflects costs incurred relevant to the voltage tier and which provides price signals via demand pricing within an agreed framework.

Adoption of a common policy would facilitate more effective benchmarking and would prevent price distortion across customer groups.

If you have any queries regarding this consultation, please do not hesitate to contact me.

Yours sincerely

RUSSELL WARD
DIRECTOR OF LEGAL & REGULATORY AFFAIRS

ELECTRICITY DISTRIBUTION CONNECTION AND USE OF SYSTEM CHARGES FOR DEMAND CUSTOMERS AND GENERATORS

• whether, from the descriptions given here, it appears that users will have sufficient information to estimate charges and terms under which connection and use of the system will be provided;

• whether (and on what points) divergence between methodologies is an issue, and what the consequences of these differences might be;

Divergence between the methodologies of different DNOs not which within the same corporate Group is beneficial for yardstick purposes provided Ofgem actually makes use of these yardsticks when assessing the efficiencies of each DNO. Divergence between the methodologies of different DNOs within the same Corporate Group poses problems. This is because it raises the possibility that intra-group allocations may be skewed to defend market share in the event that new entrants enter the market.

Format of the use of system charging methodologies

Views would be welcome on whether explanations of terms are a helpful guide, or aid comparison of how different companies use the same terms.

Different definitions only help DNO's to obfuscate – the customer does not benefit from different terms. A common lexicon needs to be developed across the industry.

Statement contents must include clear definitions of all terms used and concise worked examples for all common tariff sets which allow users to accurately calculate usage and measure the appropriateness of the tariff relevant to the costs incurred.

Ofgem is aware that an up to date distribution licence is not readily available to the industry (and that the recent modification to SLC4 was a substantial revision from its previous form) and would appreciate comments on whether it would be useful for the statements to briefly set out the licence requirements and associated change and dispute processes.

There is an overwhelming public interest justification for having each DNO (or Ofgem) publish the latest version of the licence on the web. It is unacceptable that there is no readily available and definitive document to refer to.

Six of the statements make it clear that they are available to download free of charge from company websites. A charge of between £5 and £10 is levied for a paper copy of the statements (in one case the charge is discretionary). Two of the use of system charging methodologies mention that a charge is payable for the methodology statement.

A charge representing the marginal cost is acceptable. It is surprising that, in the case of one DNO, the decision to charge should be discretionary – why would any entity need to exercise a discretion? This looks like an opportunity for gaming.

Three of the methodologies provide flowcharts:

We strongly support the use of flowcharts.

Worked examples are provided by some of the use of system statements.

We strongly support the use of worked examples.

General comments on the format and scope of the statements are welcomed: it would be useful to know how the statements are used, and in light of this, how much background information is needed, and to have views on where the line should be drawn between information contained in the charging methodologies and the charging statements.

Demand use of system models

The five DRM based methodologies have varied the method in a number of ways:

One DNO has outlined a simulation model which estimates the extent to which costs are customer related (non-demand based) and asset related (demand based costs).

All approaches are based on simulation models which appear to be derivatives of the EA 500MW Distribution Model. This model does not enable true cost reflectivity as base assumptions are not based on historical or actual cost modelling. It is critical that a common methodology is agreed for apportioning and determining costs if the DRM approach is to be used.

It would appear the DNO's, from the models shown, shoe-horn tariffs around the agreed price control revenue using averaging techniques to determine levels. This is clearly inappropriate and not cost reflective.

Another DNO has introduced a charge-setting model which evolved from the DRM model.

See comment above.

Yardsticks

Two of the methodologies have provided a fairly detailed description of how customer groups are determined.

Yardstick pricing can only be effectively reviewed if all the supporting information is provided which allows the criteria for apportionment to be determined.

This is very important because different customer groups have (potentially) different elasticities. It is also vital that the determination is transparent so that any re-allocation

of costs in the future can be assessed in the light of consistent definitions of each customer group.

Ofgem must not miss this opportunity to ensure each customer groups costs are accurately reflected in the prices given and ensure no one customer group susidises another as currently happens.

Long run marginal costs are then projected according to required capacity rather than calculated demand.

The LRMC should be projected according to calculated demand.

All base costs should be derived from an ABC approach. DNO's have the opportunity to employ ABC costing geared toward the voltage tier where costs are incurred these costs reflect the demand element, with non-demand costs reflected in standing charges for services such billing, call-centres proportioned across customer groups. An ABC Costing approach would allow DNO's to set prices consistently with the costs incurred during the term of the price control. This would prevent cross-subsidy and enure no one customer group is disadvantaged. It must be done consistently over all DNO areas.

Customer related costs vary according to the voltage level of connection. The remaining methodologies provide minimal detail on how customer groups or tariff baskets are determined although some mention metering and Supercustomer billing arrangements as a basis for determining customer groups.

We strongly support a move towards a substantial increase in the detail given.

Other methodologies list the possible component costs, and provide limited detail on how these costs on the system are determined or apportioned.

Component costs should be listed with a detailed explanation of which factors would cause a component to be included, which could cause it to be excluded. Details of the likelihood of a component being included should also be included.

One methodology states that a common (non-DRM based) method will be used for tariff setting across all voltage levels. The remaining seven methodologies state that site specific charges will be set for EHV customers.

All methodologies should include EHV pricing setting out the principles upon which prices are determined and giving clear indications as to how these will be implemented through use of worked examples. See Transco's C4 statement for reference.

Special arrangements and non-standard terms

We support the use of special arrangements.

All of the methodologies state that where none of the existing charging categories are deemed appropriate for a customer, special arrangements may be entered into.

Ofgem has noted that the following issues on special charging arrangements are not covered:

• charges for exceeding agreed capacity, which is only mentioned by one methodology, which states that excess use may be reflected in billing, but this does not indicate a right to use such capacity;

Exceeding the agreed capacity either has a cost or it does not. Subject to resolution of the connection boundary issue (see further below), as a general principle we believe that if there are cost implications (and there always are) those that cause the costs should pay them unless there are strong equity arguments pointing the other way. The connection boundary issue will need to convincingly draw on such issues to defeat this general principle.

• changes to agreed capacity: one methodology states that changes cannot be made within a year of connection, one within 5 years and another within 15 months. The remaining methodologies do not state how changes to agreed capacity will be dealt with; and

How changes to agreed capacity will be dealt with must be specified in detail.

• preserved charges, which are not mentioned in any of the methodology statements.

The basis for preserved changes must be set out in the methodology.

Inclusion of NGC exit charges in use of system charges

We support the inclusion of exit charges.

NGC Charges it must be clearly stated the level of charges to be incurred and the basis upon which they are apportioned with the charge separated out to ensure transparency.

Generator use of system models

Seven DNOs have provided simple capacity based models, but one has provided two models: a simple model and a nodal model which produces voltage and time varying capacity based charges.

A model is likely to be more cost reflective. As for GDUoS, generally, we are unable to comment without access to the methodologies

Inclusion of NGC exit charges in GDUoS charges

We support the inclusion of exit charges.

NGC Charges it must be clearly stated the level of charges to be incurred and the basis upon which they are apportioned with the charge separated out to ensure transparency.

There is no mention of whether exit charges will be charged in seven of the generation methodology sections.

Inclusion of business rates in GDUoS charges

Business rates should be included.

Preventing volatility in GDUoS charges

Volatility between price controls adds cost and so, as a general principle, should be avoided.

Treatment of microgeneration

No comment at this stage given the lack of sufficient information provided under this consultation.

Distributed generation and deferred expenditure: rewards for benefits to the network

This area could present opportunities for DNOs to frustrate the entry of IDNOs unless fully and effectively policed.

Transitional arrangements

No comment at this stage given the lack of sufficient information provided under this consultation.

Network access rebate payments

This area could present opportunities for DNOs to frustrate the entry of IDNOs unless fully and effectively policed.

Changes to agreed capacity

No comment at this stage given the lack of sufficient information provided under this consultation.

Worked examples

No comment at this stage given the lack of sufficient information provided under this consultation.

Format of the connection charging methodologies

In one statement, the connections procedure is laid out in diagram form:

one basic representation of the connection procedure, and one more detailed diagram of the construction and adoption process.

No comment at this stage given the lack of sufficient information provided under this consultation.

As for the use of system methodology statement, views would be welcome on whether greater detail on the licence requirements would be a useful guide for users.

This is not needed provided a copy of the licence is available on the web.

All but two of the connection methodology statements contain worked examples of various connection types, including generator connections, some using the apportionment rules and some for simpler connections.

We support the use of worked examples.

Five of the methodology statements contain glossaries. As for use of system, views are sought on whether there is a need for clarification of the use of any particular terms.

Statement contents must include clear definitions of all terms used and concise worked examples for all common tariff sets which allow users to accurately calculate usage and measure the appropriateness of the tariff relevant to the costs incurred.

Payment options

Non-standard connections

Four of the methodology statements outline procedures for speculative connections, where capacity may be reserved for development agency projects. The statements note that in these cases the right to second comer payments may be waived, and that reservation payments may be necessary. Terms will be negotiated bilaterally.

Connection boundary

Connection charges should be based on a shallowish connection policy.

Connection charges

Again without access to the proposed methodologies an informed view cannot be given. As such, we question the effectiveness of the consultation exercise in its current form.

It is important that all statements set out the basis upon which connection charges are determined, clearly show each charge and demonstrate how these will be used via worked examples. Again a common policy for cost allocation and apportionment would help ensure this is done fairly and would allow users to effectively benchmark.

Second comer charging for reinforcement

Abolition of O&M

All statements must show how O&M charge and percentage used to determine this is calculated.

Contestable and non-contestable works

Out of area networks

Some DNOs operate networks outside their distribution services area. None of the statements include methodologies for out of area networks.

This is because it raises the possibility that intra-group allocations are being skewed to defend market share in the event that new entrants enter the fray.

Out of Area Networks – Any pricing signal must be consistent with and on the same terms as those prices determined for in-area. A consistent DNO methodology approach would help ensure this happens and prices are cost reflective across the UK. Without this it is impossible to determine the appropriateness of any tariff or indeed benchmark.

Embedded Networks

A separate cost reflective embedded network tariff is required determined on the same basis as EHV charges to ensure that cost are reflective. This will ensure that items which should not be incurred some of which fall into the non-demand related category are not reflected in the prices set. Currently embedded networks are considered large single users this is inappropriate and does not reflect the cost incurred by connections of this nature.