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Dear Mark

Consultation on Western Power Distribution's Modification Proposal

Central Networks welcomes Western Power Distribution's modification proposal as a positive contribution to the debate on the future structure of distribution charges.

It is an important principle that any modification which better meets the relevant objectives set out in the distribution licence should be approved by the Authority. It is quite possible for imperfect methodologies to pass this test and against this background it is our view that WPD's proposals should be approved. Having said this, the proposal raises a number of important questions which all distributors will have to address in developing their own methodologies.

The first issue is just how far into the future it is appropriate to make projections in respect of load growth and network development. In our view it is inappropriate to attempt any projection beyond perhaps ten years into the future and, even with this relatively short horizon, it is not possible to project with a high degree of confidence. This is particularly true at a time when overall demand growth has slowed and may potentially reverse in the face of economic and environmental drivers.

Using a very long time horizon means that all nodes attract a marginal price of some sort. The implications of this may be that the differentiation of price signals between nodes will be less marked than in a methodology where price signals are focussed only on 'hot' nodes (i.e. those that are growing fast and are relatively close to their maximum capacity). This will have the effect of discouraging growth on all nodes to some extent – even those with ample capacity and slow growth – and insufficiently discouraging growth on hot nodes.

A related issue is the method of projection. It is for consideration whether it is more appropriate to use an average growth rate for the network as a whole, or to use specific historic growth rates for each node or zone. Issues created by using an average growth rate include the creation of 'hot node' price signals for all nodes where demand is close to maximum capacity, irrespective of local growth conditions (i.e. strong growth, stability or negative growth). This

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would mean, for example, that a heavily loaded node with negative growth and little prospect of needing reinforcement would attract the same price signals as another equally heavily loaded node where demand was growing very strongly and reinforcement was a realistic prospect. We note WPD's intention not to regularly change the assumed demand growth rate and this will certainly help stability of prices, but will mean that changes in actual growth on the network as a whole are largely ignored. If the average growth approach is to be adopted despite its flaws it might be more appropriate to use some reasonably long term rolling average updated each year, rather than have less frequent step changes.

Moving on to generation charges, we are reasonably comfortable with the concept of negative charges where generation can genuinely be shown to defer network costs. We also agree that generators currently not paying GDUoS charges because they were connected under the old 'deep' charging arrangements should not be allowed to opt into the new arrangements until a decision is reached by Ofgem about the long term treatment of these generators. We would not be comfortable with the extension of negative charges to demand as this would send a signal to increase consumption that would be entirely inappropriate. We therefore support WPD's plans to 'cap' demand charges at zero.

WPD's plan to base their charging model on the forecast network – including planned reinforcement and those new connections where an offer has been accepted by a customer – seems sensible in light of the uncertainty which often surrounds planned connections before customers are committed.

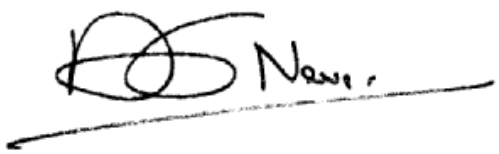
In terms of reactive power, this has a very real impact on distribution system costs and it therefore seems sensible to include some consideration of this into any cost model.

Consideration of the impact of fault level on network costs may be a significant omission from WPD's methodology. Whilst it is uncommon for fault level to drive reinforcement, when this does occur the costs can be very high. It is also worth noting that both generation and demand can contribute significantly to fault level. We agree with Ofgems's view that this is an area where the methodology could be further developed in the future.

In terms of capacity charging all large customers, both demand and generation, will have an agreed maximum capacity, whether or not they currently use this to the full. It may be more equitable to use these agreed capacities for all customers since their connection agreements typically allow them to use their maximum capacity whenever they wish.

I hope these few comments are helpful and look forward to the Authority's decision on WPD's proposals.

Yours sincerely,



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