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Dear Mark

Impact assessment and consultation on Western Power Distribution's Modification Proposal to change their Electricity Distribution Use of System Charging Model

I write in response to your recent consultation on WPD's use of system modification proposal. Your impact assessment and consultation in this area are welcome. We accept and support your need to consult, firstly as it is the first such proposal (of many) which can be expected as DNOs move towards delivering longer term charging arrangements and secondly as the proposal is a significant methodological change for use of system charging.

WPD should be commended in bringing forward this modification proposal. We recognize the considerable effort required to submit a credible modification proposal, and this has been another important step in the debate on DUoS methodologies. We welcome the opportunity to comment and have set down our views and answers to your specific questions in the attached appendices.

We recognize the constraints facing Ofgem when considering this modification proposal and the difficulty that it causes in framing the consultation. We will respond to the specific questions raised by Ofgem but we also wish to raise some wider ranging issues related to distribution network charging.

The incremental change proposed by WPD will create a series of inconsistencies between charges for different classes of network users that are difficult to ignore.

We have previously expressed our concerns over the requirement to balance back to separate allowed revenues (for demand and generation). This restricts the application of a methodology that recognizes the benefits that all parties can bring to the development of the distribution network. Separate price controls for demand and generation distort the prices that can be levied on network users and can easily produce unintended consequences. We

are reassured that Ofgem are committed to resolve this issue by constructing a single control from 2010, with an agreement that any under/over recoveries can be pooled at that time.

I hope that you find the attached comments helpful. I look forward to seeing the results of the Authority's deliberations on this modification proposal. In the meantime, please do not hesitate to contact me should you have any queries or comments on any aspect of our response.

Yours sincerely,

Mike Boxall
Electricity Regulation Director

Appendix 1 – Specific questions raised by Ofgem

WPD state that their proposal better meets the relevant objectives with regard to transparency and cost reflectivity. Does the modification proposal better achieve the relevant objectives?

In response to your question we would make the following points:

Cost reflectivity – It appears that the proposed methodology better reflects the costs imposed by an individual customer when utilising the higher voltage distribution networks. It has been previously documented that the LRIC method can over-recover the network costs and we note that within the proposed methodology (and in the modification proposal) much emphasis has been given to the stability and predictability of tariffs. We recognise the balance that needs to be struck between competing charging principles but we are concerned that the increased importance given to stability and predictability is detrimental to cost reflectivity. For example the choice of a single average ‘medium term’ growth rate for application across the network in contrast to individual nodal growth rates (both for demand and generation). In all instances the actual costs attributable to an individual customer will not be reflected into its charge as it will have been distorted through the choice of general and/or average key assumptions. What we are unsure of is the extent of the distortion

Transparency – We commend WPD for the wide publication of a significant amount of information on the development of the proposed methodology and that this transparency has allowed those interested parties to contribute to the ongoing debate. This step change in openness has contributed to an increased transparency when benchmarked against the approved methodology.

On a minor point of detail we note that the proposal document states an intention to publish more detail on the distribution network and some specific prices and yet there is no defined route or reference detailed within the proposed methodology statement. Greater transparency could have been achieved if this had been detailed in the charging methodology statement and if we had been presented with examples of the scope and content of the network and charging models and associated prices that are to be made available.

Appendix 2 – Annex 1

EHV charges – We recognise that a change in methodology will likely cause a disturbance in tariffs presented to end customers. As the methodological change is at the higher voltage network levels it is not surprising that customers connected at these voltage levels face some disturbance. In this instance, the modification proposal doesn't include proposals for transition and we support the decision being proposed as the company is in the best position to understand the issues around whether to apply transition arrangements or not.

Scaling to revenue – Our main concern over the proposed approach to scaling is that there will be inconsistency between the revenue reconciliation proposed for EHV and that existing for HV and LV for both demand and generation revenues. This seems inappropriate, even if it is the bi-product of the incremental change in methodologies. A minor concern is the apparent lack of reconciliation for the EHV customers back to the allowed revenue for these customers.

Generation Tariffs – We support the proposal to recognise the benefit afforded by generation for its contribution to reducing network reinforcement through its P2/6 contribution. We are surprised that this key principle is not reciprocated in demand charges and we discuss this later.

We support the proposal to cease the opportunity for existing generators to opt into the proposed charging arrangements for EHV connected generators. Although we understand the scope of the modification proposal being presented to the Authority for its consideration we are concerned that if it is not vetoed then there will be an inconsistent methodological approach between EHV generators and HV and LV generators, connected post April 2005. This proposal raises a further difference between generators (whether connected pre and post April 2005) and we urge Ofgem to resolve the uncertainty over the generator charging regime post 2010. There is a need to quickly define a common approach and plan for the alignment.

New Connections – We support the inclusion of those proposed elements of the network identified as 'committed' within the modelling regime as the calculated network costs will reflect the forward looking configuration of the network.

Sole use assets/contributions – We note and support the proposal to include amounts to recover the future asset replacement and operation and maintenance of the sole use assets as it is consistent with the approach approved at the lower voltage levels. However it appears that no adjustment is made at the EHV level for customer contributions (with the exception of sole use assets) as is undertaken within the DRM. This inconsistency bothers us.

Capping negative demand charges to zero – We are not convinced by the arguments raised against negative demand charges for application in the longer term, but recognize that this approach is an interim measure. Negative demand charges are wrongly perceived as

encouraging load growth and therefore the concept appears to run contrary to the need to conserve energy through energy efficiency. However, negative demand charges recognize the potential benefits that existing or new demand customers may provide through deferring network reinforcement. We are concerned that the proposal is inconsistent for demand and generation customers and should only be applied until 2010.

Reactive power charges – We are not surprised at the range of impacts for differing injection power factors indicated within the modification proposal as the calculations are highly non-linear and heavily dependant upon the initial conditions. We too are concerned by the trade off against cost reflectivity, but are unable to comment further as no information has been provided on the impacts for either individual customers or customer groups.

Growth rate – In the earlier consultations we expressed our reservations on the use of a global growth rate and the limitations on low or negative growth rates. We understand why the global approach has been taken but our reservations over the dilution of cost reflectivity for price stability still remain and we question whether the appropriate balance has been achieved.

Thermal model – We acknowledge the limitations of the approach proposed and the reasons given but we also support the reply put forward by Ofgem. One possible solution is to consider the expenditure on fault level reinforcement, not recovered from the individual connectees, as an annuity that is recovered across all customers utilising those assets.

Chargeable capacity – We too wish to express reservations over the use of differing modelling assumptions for demand and generation and the subsequent impact that this could have on the relativity of use of system charges for each customer type.

We note that Ofgem has not commented on the future asset replacement, NGET exit charges and. We make the following points:

Future asset replacement – We question whether it is appropriate to apply specific and generic charges for future asset replacement of sole use assets for EHV and HV/LV connected demand customers respectively and the also whether it is appropriate not to do so for generation customers.

NGET exit charges – We are not convinced by the arguments not to attribute or allocate the costs from NGET exit charges and to let the revenue reconciliation process allocate the required revenue. If there is not a suitable attribution process then the fair allocation of the costs that reflects the drivers for the capacity offered by the connected to the transmission network. Our concerns centre on whether there could be some unintended consequence.

Appendix 3 – Annex 2

No comment.