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29 April 2002

Arthur Cooke
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Dear Arthur,

Distributed generation: price controls, incentives and connection charging

Ofgem's March 2002 document summarises responses received to earlier consultations and whilst does not appear to make any new proposals, does revise how Ofgem intends to take forward proposals already suggested. In our response, rather than comment on comments received from earlier consultations, we will confine ourselves to Ofgem's recommendations for implementation and work.

Looking at Ofgem's recommendations for early implementation we would comment:

- ***the option of 'annualised charging' under existing connection charge methodology.***

We were disappointed that this was suggested in the paper with virtually no discussion of the practicalities involved and set against the acknowledgement by Ofgem that it will increase the risk on a distributor. We do not believe it is appropriate for distributors to pick up any additional risk from these connections and as such we do not believe that we will be able to offer this option to generators at a lower cost than commercial lending institutions without introducing cross subsidies to other customers.

To offer this option it will be necessary for a distributor to raise additional funds above those allowed for by DPCR3. These would clearly have to be at marginal commercial lending rates which would be high for a highly geared company. It may also threaten the investment grade credit rating of such a company. In addition if a generator terminated early, then unless there was a termination charge the stranded assets would have to go into the RAB and be paid for by other customers. The paper suggests termination payments. As early'termination is likely to be accompanied by the financial failure of the generator it would be necessary for this to be guaranteed by the bank. Clearly this would cost and we remain of the view that the option of 'annualised charges' would be a greater cost to the generator than financing the connection directly with the bank.

- ***consultation on reimbursing non-domestic 'initial contributions' from proceeds of later connections***

We support a wider consultation on this issue. The paper discusses the relative complexity of maintaining data bases to allow this to happen. At present the regulations are limited to domestic premises where the original applicant and current occupant are the same person. In practice this is 'one off domestic connections only and the numbers involved make the situation manageable. Equally if it is extended only to generators, it is also likely that information can be handled. To extend the principle to all domestic and non-domestic connections, however, would place a considerable administrative burden on distributors, if not carefully defined. In addition domestic customers usually have similar characteristics so division of the costs of commonly used assets can be achieved easily. If the principle is extended to generation there should be clear rules for apportioning costs for different size schemes.

In the consultation Ofgem state that a distributor currently has the option to charge an initial contributor a lower amount and recover the costs from subsequent connections. This is not correct, section 19 of the Act does not permit recovery of costs of existing assets from persons requesting connections except where permitted by the Electricity (Connection Charge) Regulations.

- ***establishing agreed classification (banding) of distributed generation***

We support the classification of generators into bands and believe the most pragmatic solution is to either follow demand banding or technical boundaries as closely as possible. To this end we suggest the following alternative banding: -

Band 1	In accordance with G83 (3.5kW)
Band 2	LV Up to 100kW
Band 3	Other LV
Band 4	HV
Band 5	EHV (as defined in the licence)

For demand customers the 100kW boundary always appears odd and one nearer 70kW (or the boundary between whole current and CT metering) may have been more sensible. In introducing banding for generators, this may be a more sensillle boundary.

- ***separate and appropriate identification of import and export active power quantities as the general commercial best practice for distributed generation***

We fully support separate import and export metering. We note that even with this there will be a reduction in units distributed on a distribution system without a corresponding reduction in costs. This is an issue for the next price control. With regards to only recording active power, we agree with this for the smallest generators, but believe it is necessary and appropriate to record reactive power flows for larger generators (or record export in kVA).

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This has a direct impact on system ratings etc. The requirement for recording reactive power (or kVA) should be linked to banding and should be mandatory. We would suggest all sites over 100kW should have this requirement. Where reactive power is not recorded, generators should be confined to operate within certain power factor parameters.

- ***protecting the commercial position of existing distributed generation***

In general we are against significant price disturbances. However, we recognise that any proposals which treat some generators different to others must be capable of being supported by distributor's systems. This is likely to be easier for site specific sites. Where sites are not treated on a site specific basis it is likely to be more pragmatic to treat existing and new generators the same.

- ***full and comprehensible information for all prospective distributed generators.***

We believe information should be relevant and comprehensible. This is best achieved by liaison and understanding between distributors and generators and good progress is being made in this area with the work on the condition 25 statements. We support development of this rather than simply obliging distributors to publish information which may or may not be relevant to generators.

The paper indicates a number of areas where further work is proposed to start. We support further work in these areas and will comment in detail once firmer proposals are known. We also note that Ofgem will consider a number of issues as part of the next price control and again will comment in detail as part of the price control process.

There are a few other points raised in the paper which we would wish to comment on they are: -

Deferment of reinforcement: Generation is rarely an influencing factor in reinforcement which is often associated with asset replacement due to age or safety considerations. In the few cases where it may occur, there should be no presumption that generation offers a more economic solution and any benefits should only be given where there are contractual commitments on both sides.

Network analysis: The increasing number of generators and the change in behaviour of the network due to them is likely to make network analysis more onerous. It may also promote a need for new analysis software, further increasing costs. These costs should be recovered from generators if no cross subsidy is to occur.

25% rule: In the paper, Ofgem suggest that the '25%' rule is equally applicable to demand and generation. This is not the case. The Licence only refers to the '25% rule being applied 'normally'. In practice the '25%' rule is part of the complex definition of the boundary of connection and use of system charges when applied to demand customers. The effect of the rule is to define whether the cost of a particular asset should be recovered from a person requesting a connection as part of their connection charge or from all the existing customers (plus the new customer) using that asset through use of system charges. As there is currently no use of system charges for generators and all connection charges are 'deep' the '25% rule can not logically be applied to generators. Its applicability to generators would only be relevant in the context of use of system charges for generators.

If you have any questions on our response we will be happy to discuss them further, please contact us.

Yours sincerely

S P Evans .

pp **Andy Phelps**
Director, Regulation and Finance

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