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Dear Arthur

Distributed Generation: Price Controls, Incentives and Connexion Charging – Further Discussions

We are pleased that many of the points we made to you in our letter of last November seem to have been endorsed by your own views in this discussion document. We particularly welcome the recognition that the imbalance of renewable resources across Great Britain implies that there is likely to be a more significant effect on those companies operating networks in the North and West.

Nevertheless we remain concerned that the pace of change remains too slow to achieve the government targets. We recognize that Ofgem's ability to influence the growth of renewable generation must be taken in context with Ofgem's statutory duties, and in particular we recognize the subtleties in protecting customers rather than the wider issue of protecting citizens and the environment. We remain concerned that more cannot be done in the short term to foster incentives for growth on DNOs. This also is underlined by our September 2001 article in the Utilities Journal which we copied to you in November. There is a need to consider how the changes to the industry are funded. We made the point that in the long term DNO shareholders can not foot the bill. In this context we were particularly interested in your comments in 3.79 on the need to invest in strategic reinforcements. Recognizing the potential growth in our region, this is something of paramount interest to us, and we would like to discuss this with you further.

We are also concerned that your paper raises a number of issues that need to be developed as part of the 2005-2010 price control review. We know from our discussions with Richard Ramsay that much of the design work for the next review will need to be established and largely finalized by Christmas 2002, and we are therefore concerned that adequate resources are brought to bear on this within Ofgem.

We also note that the Renewables Obligation seems to be starting to have an effect on project viability, as seen in the apparent increase in connexion applications in Scotland. Your consultation paper hardly considers the funding opportunities for development that the Obligation might provide.

In the following section we make comments on the specific proposals in your paper, on your suggestions for Ofgem workstreams and we have included a small number of detailed comments in an appendix.

Ofgem's Proposals

Connexion Charges

We wholly support your decision that in the short term that connexion charging policies are essentially unchanged. We also note the suggestion that the connexion charges can by annualized over a number of years. We already make arrangements such as this in a minority of cases, and we see no reason why the practice should not be extended subject to us continuing to manage our risks as to the credit-worthiness of applicants. We recognize your suggestion of a boundary (ie between connexion and infrastructure) for the treatment of these costs and see no objection to it. We also note the argument regarding the deferment of asset replacement expenditure. Again we have commonly adopted this approach when connexion work has caused the premature replacement of assets and standardizing its use will not give rise to any problems.

As we explained in our letter of 22 March 2002 to Charles Coulthard which we copied to you, we do not foresee that there will be sufficient growth of generation to make GDUoS a viable and stable means of cost recovery for some time to come.

Second Comers

We support this approach but obviously we will await the outcome of any formal consultation on a new Statutory Instrument before formalizing our approach. Nevertheless we will commence making appropriate records such that adjustments can be made for second comers.

Banding

We support the concept of banding, particularly as you remark for DCHP and for EHV connected generation. We will be contributing to the development of this work.

Metering

We support the use of accurate metering wherever possible. We support Ofgem's insistence on import/export metering for every generator installation.

Existing Generation

We agree with your views that existing generators should not be affected by these proposals, although applications for them to vary their connexion terms would be treated under any new rules for the incremental part of the application.

Information

We support the view that the consultation process to introduce the LC25 statements is an appropriate step in making the right information available to developers and others.

We think it is probably overstating the case (in 3.92) to say that it has already had a significant effect, as most companies are in the process of publishing their first drafts.

Issues that can be addressed now as Ofgem Workstreams

Establishing when the underlying conditions change

The questions raised here are all pertinent question for the next price review. It is probably still not possible to forecast when any of these can be said to have passed a clear threshold and need to be treated differently. For example parts of our network already have reversed power flows, and are actively managed, but this is small scale compared to the whole network. The design of subsequent price controls needs to accommodate these changes as they develop in real time.

P2/5

We note the work in the Technical Steering Group (TSG) to consider changes to P2/5 to make it easier for DNOs to recognize a security benefit from generators. However we would re-iterate that this will not immediately result in significant value to generators as networks are all already P2/5 compliant as required by the DNO licences.

Benefits of Distributed Generation

We are not clear whether you see this as an discrete activity that is to be picked up by Ofgem, or whether you are implying that this work lies within the TSG.

Standardization of DCHP

In general we agree with Ofgem's comments on DCHP. We expect to contribute to the debate concerning the design of industry arrangements through the TSG process. We assume from Chapter 8 that Ofgem sees most of this development work occurring in the TSG, with the Distributed Generation Co-ordinating Group maintaining oversight. We support this view.

Performance Standards

We too share your concerns that developers enjoy a timely and appropriate service when discussing plans with DNOs. We do not believe that there is a case for a penalty based régime, but we would support the introduction of an overall process monitoring measure.

Premium Power Zones

The development of premium power zones is probably only giving a name for the way in which a DNO, when appropriately incentivized, would develop its network. It is clearly logical and efficient to prioritize network development and to attract generation to those places where the network has been so conditioned.

Given the wide variety of network conditions in Great Britain, and the varied local conditions and availability of fuel sources, we believe that any workstream should be limited to designing incentives for DNOs to develop such Zones, rather than dealing

with any detailed technical or commercial issues in the establishment. These latter issues are better developed by DNOs.

Conclusions

We recognize that the proposals you have put forward in this paper are generally appropriate and we will continue to support development work in these areas. We remain concerned, however, that DNOs will be insufficiently incentivized to fully participate in transforming the electrical generation landscape in the UK. You clearly play these discussion back to us at the start of Chapter 8, but the topic as an element of the price review only merits one paragraph at the end of the chapter.

As I said early in this letter, this issue is clearly bound up in the development work of the next price review that is just starting. We had hoped for a more concrete start to the necessary debate on incentivizing DNOs to develop distributed generation and to transform the network, particularly given the relatively short time available to develop the price review methodology.

The document is also unclear as to what the next steps are. In the absence of any comment in the paper we assume that the issues will be developed under the overall guidance of the DGCG, with the distributed generation issues for the price control now being developed under the price control workstream in Ofgem. Some confirmation or discussion on this last point might be useful and I will be in touch.

Lastly I hope the comments we have made here are helpful and constructive. As ever, please do not hesitate to get in touch if you would like any point clarifying.

Yours sincerely

Signature Not Verified

Digitally signed by Mike Kay
DN: cn=Mike Kay, o=United Utilities, ou=Group Strategic Planning, c=UK
Date: 2002.05.07 19:18:53 +01'00'
Reason: I am the author of this document

Mike Kay
Electricity Regulatory Affairs Manager

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Appendix

Points of Detail

25% rule does not apply to generation

We are surprised by your assertion that the 25% rule applies to generation (2.38). We are clear that the rule applied to demand-only customers when it was introduced in 1995, and although the wording of Condition 4 has change subtly since then, we would still interpret it as applying to load customers only. In any event there are significant practical difficulties in applying such a criterion to issues such as fault level capability, and other network problems as raised by the with/without test described below.

Distinction between generation and demand

Whilst supporting the arguments contained in the consultation paper on this issue, we would also wish to point out that the design of the network for unidirectional power flow from Grid to customer exit point will reinforce this distinction for some considerable time, if not always, until the effects of this design approach are marginalized by new developments. It is also worth reminding ourselves that there is a significant distinction between DNOs networks and NGC's in this regard. NGC has a similar number of nodes supplying demand to those accepting generation. DNOs currently may typically have ten thousand times more demand exit points than entry points. It will be a long time therefore before the network requirements to supply demand will not dominate those related to the connexion of new generation. In this context it must be noted that deep reinforcement charges only represent the short-run marginal cost of connecting generation.

Deep v Shallow

We do not believe that the case against deep charging is made sufficiently so that you can "conclude that deep connexion charging……. can constitute a barrier to the successful completion of at least some schemes" (section 3.60). Indeed, a little earlier in this chapter you quote our own research on the reasons why renewable projects do not proceed.

With/Without test

We support the view that the time is not right to advocate the use of with-without tests for establishing the value or otherwise that distributed generation brings to the network. Our view is based not only on the practical difficulties and costs of modelling, but also on the uncertainty of issues such as security contributions, loss modelling, allocation of fault level contributions, allocation of network assets. If such methods of evaluation are to be promoted, some work will need to be done to advance understanding on (at least) these issues.

Zonal Charging

It is not clear to us that there is any real future in a zonal charging arrangement. Any comparison with NGC's zonal charging arrangement is questionable. DNO networks are significantly different in two respects. Firstly is the very local nature of constraints on networks in contrast to the huge geographical regions divided by transmission system constraints. A change of location of only two kilometre (say) could present a completely different set of 11kV constraints. The second point is that a transmission system is essentially a single voltage network. If a connexion is required to a transmission system then there is only one transmission network at any one geographic location (although it might be operating

at one of two voltages). For a typical distributed generator there is likely to be a choice of one or two voltages at which it might connect, and subject to constraints from up to three geographically overlapping networks. These complexities as seen from any individual location, coupled with the rate of change of the system, suggested that trying to effectively model network costs and reflect in a zonal charging structure will not be cost-effective.

DPCR

We generally support the comments made in Chapter 8 relating to the next Distribution Price Control Review.

The important exceptions is the implication in 8.36 and 8.37 that Ofgem does not see it as its duty to protect customers in networks were there is significant embedded generation growth. If more costs in connecting generation ultimately fall on customers through DUoS charges then this is a cross subsidy for customers in other parts of the country having their environmental benefits met by customers in the first area. It must be more equitable to either provide the funding for network change from a central source, or by ensuring that generators pay these costs which then can be recovered through suppliers.