The RPA's response to Ofgem's second consultation on the electricity distribution price control review - DRAFT

Introduction

The RPA welcomes the opportunity to comment on Ofgem's second consultation on the DPCR. Our comments, which are restricted to issues that affect distributed generation, are set out below under the headings that are used in the consultation document.

However, this issue is also closely related to the treatment of distribution losses and the structure of distribution charges and it is important that the way all three areas are treated is consistent and incentives in one area do not undermine those in another. We therefore feel it important that before any final decisions are reached Ofgem reviews and consults on the way the incentives in these three areas will interact.

Form and Scope of the Price Control

Revenue drivers

The RPA continues to believe that a revenue driver based on units distributed creates a disincentive to DNOs to connect distributed generation and does not reflect the costs DNOs incur. Therefore we urge Ofgem to discontinue this mechanism.

In this context, the RPA welcomes Ofgem's commitment to undertake some more work in this area. However, we suggest that the scope of the additional work should be extended to assess the interaction with the incentives to connect distributed generation. This will be particularly important in the context of schemes that are less attractive to DNOs (for example schemes where connection costs are high, or where reinforcement work may deliver more capacity than required by an individual distributed generator such that a smaller RoR is achieved with a fixed £/MW incentive).

NGC Exit Charges

The RPA notes, and supports, Ofgem's comments that allowing full pass through of NGC Exit charges reduces the incentives on DNOs to develop their networks and that incentivising DNOs on Exit charges may encourage connection and use of distributed generation. Therefore, we support the use of incentives on DNOs to manage NGC Exit charges.

Non-contestable connection charges

The RPA notes and welcomes Ofgem's comments on the treatment of contestable connections and considers that competition in connection services should be expanded where possible. We also support the development of further service standards across the spectrum of non-contestable services.

The RPA is concerned by the comments that DNOs may have cross-subsidised between contestable and non-contestable activities and the suggestion that they may be earning excess returns in the non-contestable market. If there is evidence to this effect, we would expect that Ofgem would not only develop arrangements to protect against this in the future but that any previous excess is returned to system users.

Distributed Generation

Incentive Framework for distributed generation

General Comments

The RPA notes and supports Ofgem's continued commitment to encouraging DNOs to connect distributed generation and invest efficiently and economically. However, we are concerned that the proposed approach may not always deliver the intended benefits and may lead to higher costs and lower (and/or slower) connection rates in some circumstances.

- High Costs

DNOs will face a strong incentive to connect DG in locations where the cost of connection is low and could make very high returns, particularly where the costs are lower than those assumed when setting the scheme parameters, the cost of which will feed through into higher costs to customers.

- Lower (and/or slower) connection rates

DNOs may be discouraged from investing in locations where the cost of connection is high, particularly if they face a return that is lower than their cost of capital. The incentive scheme could also lead DNOs to prefer to make incremental investment to support connections that are tailored to the size of a connecting generator which may be sub optimal in terms of overall costs and/or delay larger reinforcements until there is sufficient committed generation to use all the capacity created. Both approaches could lead to slower connection rates in the longer term.

Given the range of connection costs quoted it seems probable that, with a generic approach, the returns and the strength of the incentive to connect could vary significantly between DNOs.

These considerations suggest that, if the proposed incentive arrangement is introduced, consideration should be given to using a high pass through rate and a lower incentive element. It may also be appropriate to consider tailoring the arrangement to individual DNOs' cost structures, although this would not address the issue of distortions within a DNO region. Consequently, Ofgem will need to be rigorous in ensuring that DNOs are not able to respond to any distortions inherent in the incentive structure. It is also imperative that the introduction and operation of any incentive scheme does not in any way undermine the DNOs' obligation to connect.

In addition, the RPA is keen to ensure that any incentive arrangement should also properly encourage innovation and, where appropriate, active management of networks.

It should be noted that, whatever arrangement is introduced, the RPA considers that the distributed generation community should not be exposed to the cost of any incentive element as this would be economically inefficient.

The only significant economic benefit to demand customers of charging generators for distribution services is delivered through the site specific/locational charges that reflect the differences in the cost of connecting/generating at different locations on the network. To charge any non locational costs to distributed generation would prejudice the ability to meet, and benefit from, government targets and/or lead to higher prices in the longer term. Therefore, in the interests of efficiency, the cost of the uniform element of costs should be recovered directly from demand customers.

Our detailed comments on the proposed scheme, and the suggested scheme values, follow.

Pass Through

The RPA supports the use of a relatively high level of pass through. We would be concerned if the rate were significantly higher than suggested as it could encourage DNOs to undertake nugatory work. Equally, if the level of pass though is too low, DNOs would face a strong incentive to delay investments until there is certainty that distributed generation projects will go ahead that make full use of the capacity delivered by any investment or to invest incrementally, which may be sub optimal.

Incentive rate

The RPA supports Ofgem's desire for simplicity and agrees that a flat £/MW approach has merits in this respect. However, as noted above, the RPA is concerned that this approach creates a stronger incentive to connect generators where the connection costs are low and a far weaker incentive (and even a disincentive in some circumstances) where the connection costs are high. This distortion is greatest for the lower pass through rate. We are particularly concerned at the need to take the higher figure in Table 5.3 to meet both of Ofgem's proposed criteria which results in a return substantially in excess of 7.5% for a "typical" £50/kW cost connection.

It also seems probable that some DNOs (particularly the DNO quoted as having an average portfolio cost of £10/kW) could make very substantial returns under the proposed values.

In addition, the RPA is concerned that a £/MW incentive could result in a high volume of connections but that network access may be reduced through increased constraints. This highlights the importance of compensation for access failure and understanding the interactions between different aspects of the DNOs' price controls and charging structures.

On a point of detail, it is not clear how the incentive arrangement would operate for connecting on-site generation.

The RPA is unsure about the potential value of allowing DNOs to choose which pass through and incentive rate combination they should be subject to. We would expect (quite reasonably) that each DNO would choose the one that gave

it the highest reward for the level of risk it was accepting. If two options are retained, we suggest that Ofgem should select the scheme it considers is likely to deliver the most efficient outcome in each DNO's region.

Compensation for network access failure

The RPA strongly supports the introduction of compensation for failure of network access. The commercial consequences faced by distributed generation of variations from forecast output are significant and can affect the commercial viability of projects. Where those risks are within the generator's control, or arise from the nature of the generation project, then they are best managed by the generator. However, where they arise from network failure the generator should be compensated and the DNO should face a commercial disincentive to reduce access.

The RPA agrees that compensation based on an amount per kW divided by the number of hours of network unavailability is grossly inadequate. This does not compensate generators or provide any substantive incentive to DNOs to optimise network availability. Nor do we consider that multiplying this value by a factor of ten is sufficient. For renewable generators, it is not only the power, but the ROCs which are lost, with the latter of course, having the higher value.

For the avoidance of doubt, the RPA supports the ability of a distributed generation to agree a lower cost connection and accept a lower, or zero, compensation for access failure.

Registered Power Zones and Innovative Funding

General Comment

The RPA notes that Ofgem has yet to decide whether to take forward its proposals on IFIs and RPZs. We remain committed to the introduction of these schemes, in particular the use of RPZs (subject to cost recovery comments noted below). We believe that there is a real need to encourage innovation by DNOs and distributed generation. Ultimately, such an approach should deliver significant benefits to customers in terms of cost and efficiency in network development and should assist in delivering government targets for distributed generation.

DNOs are reasonably expecting to be compensated for the additional risks they might face in developing RPZs; the same principal should apply to those distributed generators who are assisting in pioneering new approaches, and they should also see lower costs. Willing participants would be few and far between if they face higher costs or significant delays in connection lead times.

Equally, the RPA believes that it would be economically inefficient and inequitable for any shortfall between generator charges and DNO income within RPZs to be funded by the wider distributed generation community. The ultimate beneficiary of such schemes are future generators and demand customers who connect once the benefits are proven, and customers who will benefit from more efficient network development and the impact of lower costs for distributed generation in the future. We see no reason why there should not be some spin off benefits for future demand connectees from RPZs.

These considerations mean that our support for RPZs is heavily caveated by the need to ensure that an appropriate funding mechanism is put in place and that the costs are not borne exclusively by distributed generation. This consideration also applies to the more detailed comments that follow.

Innovation Funding Incentive

We note and support Ofgem's suggestion that the IFI arrangements should be simplified. We also agree that DNOs are more likely to make use of the IFI opportunities if a higher pass through is allowed and would support the range suggested provided the innovation is funded by those that ultimately benefit from the schemes – consumers. To pass the cost to distributed generation would result in the overall cost to customers being little different (but arising in different places) and / or further prejudicing the ability to meet government targets for distributed generation.

An alternative (or complementary) approach to allowing different levels of pass through over time might be to allow a higher pass through on cooperative projects between DNOs where there is a greater opportunity for the benefits of innovation to be shared.

RPZs

The RPA supports the concept of a Panel that recommends RPZ status, with representatives that are independent (or largely independent) of individual company interests. Sectoral expertise is, however, essential. Independence could be enhanced by sectoral representatives being nominated by the D Code Panel, or trade bodies, and thus attracting a wider degree of cross sector support. Because of the need for independence, we support the proposal that

Ofgem retains ultimate responsibility for decisions and that the Panel would operate in an advisory rather than a decision making role.

The Panel should be bound by objectives that closely reflect Ofgem's statutory objectives and Government's objectives as set out in the White Paper and advice to the Authority.

The RPA agrees with Ofgem's view that the potential to deliver benefit is a critical selection criterion. This implies both a significant benefit and a high probability of success. However, this criterion should not be so narrowly drawn that it rules out schemes with moderate benefits (with a high likely success rate) or prevents innovation. We also support the proposal that the potential for widespread adoption should also be one of the selection criteria.

The RPA considers that it is premature to determine whether only Gold standard schemes should be retained, although we support the principle that schemes with larger potential benefits should be more likely to be accepted and should attract a higher incentive reward.

The RPA supports simplicity wherever possible. However, as noted above, we have a number of concerns about the use of a flat rate incentive payment to DNOs and these concerns become more significant where a higher level of incentive payment is proposed. We have particular reservations about the suggestion that the connection incentive rate is simply doubled.

We suggest that, if a Panel is established to recommend whether a proposal should be granted RPZ status, that Panel is best placed to determine what level of incentive payment is appropriate on the basis of cost, merit, and risk. Although it may be appropriate for Ofgem to specify the range of values that might apply. This approach would also obviate the need to specify whether there are one (Gold) or several categories of scheme. It does, however, strengthen the need for impartiality of the Panel.

The RPA notes Ofgem's desire to cap the costs of RPZs. However the RPA considers that, if a cap is set, it should be based on any excess cost over that which would have been incurred for a normal connection rather than being an absolute cap on the cost of RPZs.