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Dear Nienke

Electricity Distribution Price Control Review: Regulatory Impact Assessments

We have recently responded to Ofgem's March policy document on the above. At the same time as the latter document was published, a Regulatory Impact Assessments (RIA) was published on distributed generation and the structure of distribution charges.

I now attach comments on this RIA and hope that these are helpful.

Yours sincerely

Rob McDonald
Director of Regulation

RIA on Distributed Generation (DG) and Structure of Distribution Charges

Incentives for Investment

We note that, in this document, Ofgem have brought together the previously separate RIAs for the development of charge structure project and for the DG incentive mechanism. These are now in a single document since both are aimed at reducing the barriers for the development of DG. A key objective is highlighted as being to provide incentives to DNOs to connect and utilise DG in an “economic, efficient and co-ordinated way”.

However, as we have discussed in our responses to the main Ofgem policy papers and consultations on the subject of the DG proposals, the operation of the DG incentive scheme will, in our view, delay investment. Where DNOs perceive a risk that any of their potential investment will be rewarded at less than the cost of capital, they will delay that investment. Such a delay in investment would inevitably result in delays in MW connecting and adversely affect the Government’s targets for the growth of renewable generation. Actual investment would also probably take place in an incremental, less than optimal manner as DNOs would, by definition, be incentivised to invest only where there is certainty that the resulting MW will connect rather than to provide enabling investment in areas of expected interest to DG developers. We also note that similar incentive schemes recently introduced in gas have not yet proven themselves to be effective.

Distribution Charging Arrangements

On distribution charge structure, Ofgem have recently formally proposed significant licence modifications to allow for regulatory approval of DNOs’ connection and use of system charging methodologies. We are surprised that there is no mention in the RIA of this step, as it will clearly increase costs for DNOs and for Ofgem in establishing, consulting upon and reviewing methodology statements going forward. As we have noted in previous discussion and correspondence on this subject, the EU directive 2003/54/EC does not, in our view, require such an intrusive regulatory approach.

Options Considered

In paragraph 2.7 of the document, Ofgem reviews the options considered for the arrangements relating to DG. Under the “DG incentives” options, the hybrid mechanism is mentioned along with “an incentive based on network availability”. As noted in our previous responses, we are not in favour of such an incentive mechanism and fail to see why it forms an integral part of the “DG incentives” option. Such an incentive will increase the potential costs and risks of the price control proposals, particularly in areas with large amounts of DG forecast to connect, and this factor would need to be considered as part of the price control settlement.

Impact on Distributed Generators and on Customers

In Ofgem’s consideration of the impact of the proposed charging arrangements, it is suggested that all DG will benefit, despite the proposed introduction of generator use of

system (GDUoS) charges. We agree with Ofgem that it is difficult to quantify the marginal impact that new charging arrangements will have due to the variety of factors that affect DG investment decisions. However, we feel it is worth noting that some DG projects that currently do not require system reinforcement in order to connect (and therefore are optimally located on the system) will see increased costs under the new arrangements. Under the proposed new charging arrangements, such schemes will also have to pay GDUoS and for some potential schemes, this may result in them not going ahead.

In trying to reach an assessment of “risks and unintended consequences”, Ofgem sets out a worse case scenario where costs to generators are capped at £50/kW per year but the equivalent costs borne by customers would be 42p per year. This illustrates volatility and risk for generators with GDUoS charging. We expect that many DG installations could not cope with distribution charges per kW/annum in double figures. We therefore support Ofgem’s proposal that caps are on GDUoS are put in place. Ofgem’s figures suggest that this would protect DG, while not risking significant disturbance to demand customers.

Impact on DNOs

We welcome Ofgem’s acknowledgement that DNOs will face implementation costs in moving to the new charging regime. These, together with costs associated with reporting and monitoring need to be explicitly allowed in the price control settlement.