

# **STRUCTURE OF ELECTRICITY DISTRIBUTION CHARGES, UPDATE AND LICENCE MODIFICATIONS, APRIL 2004**

## **SP TRANSMISSION & DISTRIBUTION RESPONSE**

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### **1 Timetable**

We continue to believe that, whilst Ofgem's proposed timetable is challenging it is still achievable, and we will continue to give active support to Ofgem to meet this challenge. We note Ofgem's proposal to reduce the notice period for changes to Use of System charges to three months which will assist in meeting the timescales.

### **2. Licence modification**

2.1 In broad terms we agree that the licence changes meet the requirements of EU directive 2003/54/EC. However, we note that a number of changes are based on existing provisions in NGC's transmission licence. We see scope for achieving greater clarity in some areas, and also to remove some apparent anomalies in the current draft. Suggested changes to the current text are set out below.

2.2 Whilst we agree in principle to the proposed Licence amendments, there is probably merit in Ofgem meeting with the DNOs to agree the necessary wording changes.

### **Definitions – Condition 1**

2.3 It is unclear why the definition of connection charging methodology refers to "better" achieving the relevant objectives, while that for use of system charging methodology omits that qualification. We would propose that "better" is removed from the connection charging definition.

### **Use of System Charges**

#### **Condition 4 – Charges for Use of System**

2.4 In paragraph 1(c), we do not see the need to refer to charges for "availability of distribution capacity". This should be deleted and replaced with "use of".

2.5 The last sentence of paragraph 2 (beginning 'Without prejudice') is obscure, but appears to provide for charges to be made other than in conformity with the charging methodology. As revisions to charges are covered in paragraph 6, and changes to the charging methodology in paragraph 3 of Condition 4A. This sentence tends to confuse matters and should be deleted.

2.6 For the sake of completeness, paragraph 5, which provides for the licensee to be able to charge according to the charging statement, should begin "Nothing in this condition or in condition 4A".

2.7 Paragraph 8, relating to charging provisions in DUoS agreements, is also not required. It is unclear why this is needed, as it appears to add little or nothing to the requirement on the licensee to issue a statement of charges, and to conform to the approved charging methodology. It should therefore be deleted.

#### **Condition 4A – Use of System Charging Methodology**

2.8 In paragraph 3 there is a requirement to submit all modifications to the methodology, however minor, to the Authority prior to implementation. There should be a means for minor amendments to be carried out without the need for detailed reports to be required. We therefore suggest that the beginning of this paragraph should read, "Except with the consent of the Authority, or in the case where minor modifications are proposed, so long as the licensee has submitted the proposed changes to the Authority and the Authority has not objected to these within 14 days of their receipt...."

2.9 The timetable referred to in paragraph 3(a)(iii) is unclear. Is it 28 days, 3 months or 3 months plus 28 days, all of which are possible interpretations based on paragraph 4?

2.10 In paragraph 5 ('relevant objectives'), the need for subparagraph (a) (efficient discharge of obligations) is unclear, and this does not appear in the NGC transmission licence. There is also an element of circularity here, as paragraphs (b) and (c) include specific statutory or licence obligations.

## **Connection charges**

### Condition 4B – Connection Charging Methodology

2.11 Paragraph 4(b) requires that the Authority approve the statement of charges (not, as in paragraph 4(a), the form of the statement). This requirement should be deleted, as it is not required to implement the EU directive (the requirement that the Authority must approve the connection charge methodology is set out in paragraph 1). Further, the requirement that the charging statement shall be prepared in conformity with the approved charging methodology is also not required in view of the obligation in paragraph 1(b) to conform with the charging methodology. Paragraph 4(b) should therefore be deleted and cross references to it, e.g. in paragraph 5 should be amended accordingly.

2.12 Paragraph 7 - see comments above (paragraph 2.7) on Condition 4, paragraph 8. These requirements are not needed here and should be deleted.

2.13 Paragraph 9c omits reference to a fault level rule. There should be a new subparagraph (iv) which might read as follows:

“the licensee may charge at the time of connection an amount for works associated with reinforcement of the licensee’s distribution system, insofar as this is required to maintain network fault levels within rating, based upon a proportionate share of the increased capacity requirement/ contribution to fault levels at the relevant points on the system”

2.14 For paragraph 16 – timetable for revisions to the methodology – see comments above (paragraph 2.8 & 2.9) on Condition 4A, paragraphs 3 and 3(a (iii)).

### Condition 4E – Functions of the Authority

2.15 Paragraph 4 – relating to disputes over the consistency between charges and charging statements – is not required and should be deleted. Paragraphs 1 and 3 refer to provisions for settling disputes over terms for connection or use of system and should be sufficient. The proposed addition is in any case not required to comply with the EU directive.

### **3. Interim modifications**

#### **Charging methodologies**

3.1 We support the principles set out by Ofgem requiring DNOs to publish charging methodologies as we think this will improve transparency in setting DUoS Charges.

3.2 We agree that there should be a degree of consistency in the form of the DNO statements and we will work with DNOs to attempt to achieve this. However, with existing Condition 4 Statements, the requirement for Ofgem's approval of the form of the statement has acted as a barrier to their development into more user-friendly documents. Any approach to improve consistency should not inhibit the development and improvement of statements by DNOs in the future.

3.3 The methodology statements should be at a high level and should address key principles such as :-

- How DNO costs have been forecast
- How costs are allocated to different types of user
- How forecast costs are reconciled with allowed revenues

We will work with other DNOs to try to establish a common structure in the form of these statements which can then be discussed with users at the ISG.

#### **Connection Charging**

3.4 We support the move to a common connection boundary for all types of connection and a move to shallowish connection charging for generation and demand, including EHV. We support the proposed guidelines for connection charge boundary rules set out in Appendix 2 of the document.

3.5 We support the proposal to remove the 25% rule and to charge for reinforcement on a proportionate basis.

3.6 We recognise that the proposals should assist in the application of the Electricity (Connection Charges) (Amendment) Regulations 2002, though we still believe that changes to these regulations are necessary to make them workable. A DNO working group is developing proposals to address this issue.

3.7 We have concerns over the proposals to allow EHV customers to spread their connection charge payments over a period of time. We currently allow phased payments over the construction period providing that all connection charges have been paid prior to energisation. If this period were to be extended after energisation then the risk of default by the EHV customer would need to be borne by either the DNO or other users of the distribution system. Any deferred payment should include an appropriate risk premium and Ofgem's view on the size of this premium would be helpful. It is our view that any default should be borne by users as a whole and the risk premium paid by EHV customers be treated as an additional connection charge.

3.8 We support the principle that where DNOs require customers to enter into a special connection agreement under section 22 then this should be made clear in their methodology statement.

### **Generator Use of System**

3.9 Our response to this consultation does not include any commentary on the adequacy of the DG incentive, which is addressed in our response to the price control consultation sent 5th May 2004.

3.10 We agree with the general principles for setting GDUoS charges set out in paragraph 3.29 of the update document and support the view that it is for each DNO to set its generator tariffs. We will continue to work with DNOs on this and we will continue to support the debate at the ISG.

3.11 We are sympathetic to the views set out in paragraph 3.32 of the update document that minimal investment is required in the short term to accommodate micro-generation. However, we still believe that micro-generators should pay a GDUoS tariff based on the £1.50/kW incentive and the £1/KW O&M allowance as proposed in the distributed generation price

control. Should we identify areas where investment is required to facilitate micro-generation then this will be reflected in the charges to micro-generators.

3.12 We believe that some form of price guarantee to distributed generators is essential at the time they commit to a connection to remove the level of uncertainty, which is necessary if the required level of investment in renewables is to take place. We believe that some form of price cap, with appropriate indexing such as RPI, is preferable and is easier to administer than year on year restrictions. These restrictions on revenues could lead to a significant under-recovery against the DG Price control, which should be transferred to demand customers. Further work is required to set out how this will work in practice.

3.13 For the avoidance of doubt, we do not support any overall price cap for distributed generation as a whole in a DNO area. DNOs should be free to set charges for new investments based on their published methodologies and provide the necessary price signals to ensure efficient investment.

### **Billing Issues**

3.14 Any GDUoS tariff will need to have components other than just the reinforcement charge as set out in the paper. These include administration and billing charges, reactive charges, operation and maintenance of sole use assets and a charge for importing power when the generator is not operational. Whilst we accept the view that charges may be billed to either the generator or an appropriate supplier, there should only be one GDUoS bill and the generator should be liable for payment in the event of the supplier defaulting.

### **Existing Generators**

3.15 We support the view that existing generators would not be liable for such charges until 2010 with a review of this as the long-term arrangements are developed. We do not believe that generators should have the right to opt-in to the new arrangements and the treatment of all existing generators should be resolved together.

## **Power Factor**

3.16 We support Ofgem's view that DUoS charges should include a component to encourage users to control power factor.

## **Tariff Support Allowance and O&M**

3.17 We support Ofgem's proposals with regard to the treatment of operation and maintenance, which should in most circumstances be recovered through an ongoing use of system charge rather than as a connection charge. Our connection charge methodology has already been changed in SP Manweb to reflect these proposals, as requested in a previous consultation.

3.18 We still have serious reservations on the proposal to remove tariff support allowances in order to improve transparency. Our tariff support allowances are clearly set out in our Condition 4 statements and their application is clearly explained. Improvement of transparency is not a sufficient reason to remove these allowances.

3.19 Ofgem's proposals for the removal of tariff support will increase connection charges and will require re-balancing of DUoS charges to reflect a deeper connection boundary.

3.20 With regard to competition in connections, the connection boundary outlined in Appendix 2 of the update document requires that connection assets are generally funded through connection charges. It is, therefore, not appropriate for a DNO to make an adoption payment when adopting these assets as this would not be in accordance with the guidance or the connection methodology. Payments for adoption of assets would generally only apply where assets at more than one voltage above the voltage of connection are being installed, or the assets would be used to connect other customers and hence the apportionment rules would apply. Under Ofgem's proposals there is little or no incentive to adopt assets at zero cost which will generate no return. If DNOs refused to adopt assets then this would reduce competition in connections and be detrimental to customers. Ofgem is again asked to abandon its proposals to remove tariff support allowances as they are detrimental to end customers and are likely to reduce customer choice in their connection provider.

#### **4. Longer term arrangements**

4.1 We support Ofgem's proposals on the way forward to develop long-term charging arrangements. However, the long-term arrangements should not preclude the extension of the interim arrangements. Whilst we can see a theoretical case for the introduction of cost-reflective forward-looking LRIC models and shallow connection charges we have serious doubts on the practicality of these proposals. It is essential that any long-term framework has a full cost benefit analysis undertaken to justify the approach. Any additional costs incurred by DNOs in implementing these proposals must be fully recoverable.

4.2 We continue to support the work of the ISG and would support the continuance of it to facilitate the development of long-term charging proposals. We agree that there should be close ties between the Commercial Forum and the ISG.

4.3 We will consider bringing forward implementation of these long-term arrangements prior to 2010 when the proposals and the costs of implementation are clearer.

#### **5. Summary impact assessment**

5.1 We note Ofgem's decision not to issue a revised Regulatory Impact Assessment on the grounds that there has been no policy change in this area.

5.2 The proposals sets out in the document are relatively straightforward, however, some of the suggestions for long-term arrangements could be costly and we would expect a rigorous RIA to be produced before any such plans are adopted.

#### **6. Implementation**

##### **Transitional Arrangements**

6.1 We recognise the difficulty that the changes to methodology will pose for connection offers made shortly before April 2005. Our connection offers are usually open for three months and in order to take account of lead times for commencing work on larger connections. It is likely to be appropriate for all offers to be made on the new basis from January 2005. A slightly different approach may be required for smaller connections with a shorter timescale between

quotation and the works being undertaken. We need to give further consideration to the implementation arrangements in these circumstances.

6.2 We already offer generators the choice of paying a capitalised or annual O&M charge. Our view is that these should still be treated as existing generators and continue with the existing charging regime and not transfer to the interim arrangements.

6.3 We understand the concern over the transition between interim arrangements and long-term arrangements and the need to avoid further differential charging regimes. We are supportive of the proposal to incorporate the interim arrangements into the long-term arrangements but the uncertainty this places on generators needs to be taken into account even if 12 months' notice is given.