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Dear Mark

Structure of Electricity Distribution Charges – Consultation Paper: Proposed DNO charging methodology statements

I am pleased to provide comments to the Ofgem consultation on the draft connection and use of system charging methodology statements proposed by the distribution businesses.

We have supported the structure of charges work since its inception in 2000. We have contributed to the structure of charges debate both face-to-face and within the Implementation Steering Group (ISG) and we hope to continue our involvement to ensure all the issues are raised and properly debated by the participants. In our response to the April Update Paper we commented that the timetable for 2004/5 was extremely challenging, but we are pleased to see that with the combined efforts of the ISG, the distribution network operators (DNOs), and Ofgem we have been able to reach this important milestone.

Throughout the process we have welcomed the open and friendly approach taken by you and your colleagues at Ofgem and the constructive and considered comments that you (and they) have provided to date on our charging methodology statements. The comments have contributed to the debate and aided greater understanding of the underlying issues so much so that we have been able to reach an agreement on an approach or set of words. This pragmatic approach has enabled all the DNOs to reach this 'challenging milestone'.

We are concerned that the consultation is directed solely at the DNOs and no IDNO has (yet) been involved. We assume that the recent granting of two new IDNO licences has been too short a timescale to include within this consultation paper. But we fully expect the newly licenced IDNOs to participate in a similar consultation/approval process before their charges are published.



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We wish to continue membership of the ISG to help develop the framework of the long term arrangements and aid the debate on the charging methodologies. When appropriate, I would be happy to share with the ISG the knowledge and experience gained from developing with UMIST a marginal pricing methodology. In addition, we would welcome a discussion on the importance of matching a charging methodology to the price control mechanism. Specific comments relating to the future role of the ISG are contained in Appendix 1.

We see our charging methodology statements to be living documents and we intend to participate in a future charging methodology forum to listen to the comments of our customers and Ofgem in order to find ways to improve the statements in the future.

I have attached in Appendix 1 and 1A specific comments on some aspects raised by Ofgem in the consultation paper. Please note the comments contained in Appendix 1A are confidential and not for publication.

I would be more than happy to discuss any of the issues with yourself, or any of your colleagues, on a face-to-face basis. In the meantime please do not hesitate to give me a call if you have any further questions.

Yours sincerely

Simon Brooke
Structure of Charges Project Manager

Appendix 1

Chapter 4 – Summary of DNO draft documents

Non-standard connections

4.53 All of the methodologies apart from UU's outline procedures for speculative connections, where capacity may be reserved for development agency projects.

We propose to take a holistic approach to manage the creation of infrastructure for areas designated for development or regeneration. The aims of this approach are to ensure that network development (ie the extension and reinforcement of the distribution network) is efficiently managed and correspondingly that we treat all customers on a consistent basis by levying all new connection customers an appropriate reinforcement charge.

Our experience with development areas/regeneration zones is that they take many years to reach maturity and in some instances as long as two decades. We considered the five year re-allocation period proposed in Electricity (Connection Charges) Regulations 2002 but concluded that this time period is too short and therefore proposed a more practical period of ten years.

Chapter 5 – Ofgem's initial views

Reactive Power charges

5.12 Although by charging on a kVA basis rather than kW the effect that poor power factor connections have on the peak demand capacity is reflected this does not adequately reflect the effect that poor power factors have on losses. It is Ofgem's view that charges for reactive power should include both charges that reflect peaks of reactive power (kVA) and also total kVArh demand. Ofgem is therefore in favour of including charges for low power factors for large customers where there is appropriate metering installed.

We welcome Ofgem's support for reactive power charges for consumers operating at low power factors.

Generation tariffs at EHV

5.19 Ofgem's view is that whilst site specific GDUoS charges at EHV provide predictability once connected they do not provide transparency to prospective generators at the development stage. Asset specific charges represent a snap shot of costs in time and do not enable future ongoing cost messages to be charged. Ofgem considers that a tariff should be published for EHV and that this should be locational as far as practicable.

We want to encourage the connection of distributed generation in the right places and we have been looking at ways of improving the transparency of pricing with this in mind. We have been leading the way in investigating the application of nodal pricing to a distribution network, but have found some serious application issues when considering this methodology in the current regulatory context. We have chosen to apply site specific charges to generation customers connected at extra high voltage levels for a number of reasons. This approach is

consistent with our treatment of demand customers at those voltages, an important consideration if the generation customer is also a demand customer. The EHV site specific charges provide a strong locational signal, transparency of costs and future predictability of charges. We have considered the approach favoured by Ofgem, but decided against EHV tariffs, at this time. In addition, we have concluded that providing a charging map, with sufficiently disaggregated and detailed information, for potential generation customers is a significant task. But our overriding concern is that such a map may potentially provide misleading estimates that would cause confusion rather than clarity.

Apportionment rules – contestability

5.31 In the rare cases where contestable assets include reinforcement works, Ofgem views that requiring the customer to pay for reinforcement in full is not in the spirit of the apportionment rules and would not facilitate competition in connection provision. Ofgem seeks views on this.

We are unaware of a situation when reinforcement assets are classed as contestable. When an ICP provides the contestable assets for the customer and the host DNO is required to undertake reinforcement, the costs of reinforcement will be shared in accordance with the apportionment rules. We agree with Ofgem that suggesting the reinforcement should be made in full is not in the spirit of the cost apportionment rules or Competition in Connections.

Chapter 7 – Update on longer term framework

Role of the Implementation Steering Group

7.12 The ISG has supported the structure of charges project since September 2003. The group comprises representatives of each of the DNO groups, suppliers, distributed generators and customers. The ISG has met approximately every six weeks, and Ofgem has found the group to be extremely useful in taking forward the structure of charges project.

7.13 Ofgem expects the ISG to continue in its present form until at least the end of 2004 so as to ensure that the interim arrangements are implemented to plan and on time for 1 April 2005.

The current membership of the ISG should be opened up to include the newly licenced Independent Distribution Network Operators (IDNO) and if there is any interest to academics. The first group needs to be included so that the whole DNO community is represented and the second group so that they contribute in the debate on the appropriate economic models for the longer term framework. We would also like to see wider representation from the supplier community, as the group discusses requirements for the end product (ie the vision of the output) then we need more detailed supplier representation.

The future ISG should be separate from a charging methodology forum, but there should be links between the ISG and any future charging methodology forum so that useful ideas from the forum can be fed into the ISG. The main role of the ISG has to be to develop the framework for the long term arrangements.

United Utilities envisages the future scope of the ISG as:

- Develop a vision of the characteristics of the future DNO use of system pricing methodology;
- Aid debate on the charging methodology options by presenting options (e.g. LRMC, LRIC, Efficient Frontier Pricing etc);
- Aid debate on the requirements output (ie what do the charges look like);
- Aid the debate on an appropriate price control mechanism;
- Develop timescales and transition/implementation plan; and
- Discuss specific transition arrangements for charges.