



Mark Cox
Networks - Distribution
Office of Gas and Electricity Markets
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Date: 10 November 2004

Dear Mark,

**MICROPOWER COUNCIL RESPONSE TO OFGEM CONSULTATION 235/04 –
PROPOSED DNO CHARGING METHODOLOGY STATEMENTS**

The Micropower Council welcomes the opportunity to respond to Ofgem's consultation on the DNO's proposed charges for Connection and Use of System from April 2005.

The Micropower Council has a number of concerns with some of the specific proposed charges for microgeneration set out in paragraphs 4.39 – 4.42 of the consultation, as well as further concerns regarding some DNO proposals to change the structure of demand charges.

Cost Reflectivity

Mott MacDonald's recent study¹ is the only well researched and properly modelled, publicly available technical study into the cost impact on DNO networks of significant levels of microgeneration penetration. It concludes that whilst some costs may be incurred in order to accommodate large levels of microgeneration, these are significantly outweighed by savings in other network-related costs. This study "SIAM" is a comprehensive piece of analysis, which includes detailed technical modelling of different scenarios for microgeneration penetration against a variety of network types. Its key conclusion relevant to the distribution charges debate is that whilst there will be some costs incurred in order to accommodate large levels of microgeneration penetration, these are significantly outweighed by the network-related benefits, particularly from the deferral of required network investment, and reductions in distribution losses.

This is an important conclusion and one which is critical in taking forward the debate on how distribution charges (especially use of system) should be applied to microgeneration, and ensuring that cost-reflective charging structures are developed.

Given this, and the absence of any details of the charging models or detailed explanation, we cannot understand the basis for:

¹ System Integration of Additional Microgeneration – Costs and Benefits, Mott MacDonald, July 2004

- 1) In Generation Use of System Charges, the proposed indiscriminate additional charges that WPD and EDF propose to levy on microgeneration customers, irrespective of actual circumstances and actual costs incurred;
- 2) in demand charges, the significant move for SP distribution and, to a lesser extent, EPN and Central Networks West towards standing charges and away from unit-based charges.

The first of these, if genuinely cost reflective, is in direct conflict with the conclusions of Mott MacDonald's study. Against this background, we do not believe that these charges can be justified on cost reflectivity grounds.

The impact of the second of these is to reduce the benefit to customers who install microgeneration as a means of reducing their own grid-based electricity consumption. The kWh component of distribution charges for LV connected customers is intended to act as a surrogate for peak demand on the 11kV network, the principal load-related cost driver of network investment. Some forms of microgeneration, particularly microCHP, will almost certainly be generating power at winter peak, serving to reduce load on the 11kV network. The effect of the proposed move away from kWh charges makes for a less cost-reflective charge for these customers and dents the economic case for such microgenerators and, for that matter, all forms of energy efficiency.

Asymmetry of Proposed Charges, DNO Incentives and Information

We believe that the charges proposed for some DNOs are unbalanced and work only to reduce both cost and risk to those DNOs, with no reciprocal benefits for microgeneration customers who, in the majority of cases will reduce both of these.

Specifically, all DNOs have proposed having the ability to levy extra charges wherever additional costs can be demonstrated to be the consequence of microgeneration connection. Arguably EDF and WPD go further than this, because they propose to charge microgeneration customers a fixed additional charge regardless of whether this is cost reflective on a case by case basis.

Paragraph 4.42 illustrates the asymmetric nature of these proposals – there are no corresponding proposals to provide rebates on charges or payments to customers where cost reductions result. The SIAM study indicates that the predominant effect of microgeneration will be to reduce network costs, yet DNO debate and their submissions are tilted towards an assumption of cost increases.

Information asymmetry is also a serious concern. It is relatively easy for a DNO, when faced with the requirement to incur expenditure to accommodate microgeneration to identify the associated costs and levy an appropriate charge. DNOs clearly have a strong incentive to do this. Conversely, the DNO that is able to defer reinforcement expenditure, or reduce load-related expenditure as a result of high levels of microgeneration has poor incentive to recognise this contribution from microgenerators in the form of negative use of

system charges. This is evident in the proposed charging statements. In this way, customers installing microgeneration could drive apparent capital efficiencies for the DNO, for which the latter would be rewarded without any requirement to share the benefits with customers. Moreover a lack of transparency in the DNO's decision making process on individual capital investment decisions makes it difficult for third parties to scrutinise or challenge the (absence of refund) charges.

The microgeneration industry supports the notion that charges should be cost reflective, but not, as would appear to be the case in these charging submissions, where this acts one-sidedly in the favour of DNOs, and where the price control formula provides poor DNO incentives to reciprocate.

Materiality

Many forecasts exist on the likely up-take of microgeneration. The most comprehensive piece of consumer-based market research conducted in this sector applies to microCHP, and was carried out last year by the Society of British Gas Industries. It concludes, even in its most optimistic scenario, that by 2010, the level of microCHP penetration is likely to be in the region of 1.6m cumulative installations. When other microgeneration technologies are included, a very optimistic penetration would be 2 million units installed by 2010, or around 8% of households.

Against this background, it is difficult to see why this appears to be such a significant concern for DNOs in this year's price control / charging review. The microgeneration industry's preferred approach would be to avoid creating any special arrangements for use of system charging for microgeneration at this stage, until significantly more data is available from experience in the field.

In line with this, we support the pragmatic proposals put forward by United Utilities – that they do not intend to run their LV charging models until the number of connections increases. We would suggest, on the basis of the most up to date market forecasts, that this is unlikely to be necessary until the next price control review in 2009 (for the price control due to be set in April 2010), but in any case support keeping it under review until then.

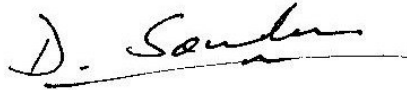
Conclusions

Given the Electricity Safety, Quality and Continuity Regulations 2003 requirement that DNOs are notified when microgenerators are connected, there is ample opportunity for DNOs to monitor the true impact of microgeneration on networks over the next five years. Proper data monitoring and incremental learning of how real networks genuinely respond and what direction costs are driven will build on the ex-ante work done in the SIAM study, and will provide a proper basis on which to take decisions for the 2010 price control / distribution charging review.

It is the microgeneration industry's view that there is insufficient information available today to allow for a charging structure that places additional charges (positive or negative)

on microgeneration customers. We therefore believe that no generation charges should apply to microgeneration customers, and would wish to highlight that no justification has been put forward in the public domain for the proposed charges by WPD and EDF. With likely levels of market penetration by 2010, this approach is unlikely to cause any material distortions in the charging structure.

Yours sincerely

A handwritten signature in black ink, appearing to read "D. Sander", written over a horizontal line.

Chief Executive