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Dear Martin

### **Licence Modifications, DG, Revenue Reporting and Quality of Service RIGs**

As you are aware we have been working with the Energy Networks Association on the working groups reviewing the licence modifications, distributed generation, revenue reporting and quality of service RIGs. We have discussed our drafting and policy issues and have agreed a collective ENA response. United Utilities supports the ENA response to Ofgem.

We do not propose to repeat the working group comments here but wish to raise a number of policy issues arising from the licence modifications.

#### **A3: Arrangements for the recovery of uncertain costs**

The proposed materiality test is inappropriate and introduces asymmetrical costs on UU. The base cost allowances within the Price Control Review Final Proposals for compliance with additional obligations under the ESQCR and Traffic Management Act have been set to zero i.e. not an estimate around which a dead-band could have been applied. Hence, the specific materiality test hurdle should be removed, allowing all efficient costs to be reported to Ofgem for consideration.

In addition, as drafted, it is unclear how the proposed test is applied. Should Ofgem impose a materiality test, the trigger level should be applied by summing the DNO total costs resulting from all years in the period 2005 to 2010 and comparing this level of costs to one years base demand revenue, say that for 2005/06. This ensures the materiality test is applied consistently regardless of the profile of actual costs incurred or planned.

#### **C1 Incentive Scheme: calculation of charge restriction adjustment for distribution losses**

The inclusion of different losses incentive roles for units physically distributed before or after 1 April 2005 introduces unnecessary complexity if introduced for standard reconciliation of

units distributed. The current practice by which reconciliation unit variances are applied in the month of discovery should continue.

The data source for the variable  $LAG_{it}$  should be derived from the licensee's calculations as Elexon systems constrain loss adjustments factors of less than 0.997 as submitted by the licensee, to be equal to 1 in the SVA arrangements. The use of data as used within the Elexon systems would provide unreasonable inaccuracies in the calculation of  $LAG_{it}$ .

**C2: Incentive Scheme: calculation of charge restriction adjustment for quality of service performance**

Paragraph 3 introduces a two-year lag for the settlement of the interruption incentive scheme mechanism. Such a lag is unnecessary and we suggest a maximum one-year lag is sufficient delay in settlement. Actual charge restrictions could be pragmatically applied through the 'K' factor.

**D2: Incentive Scheme: calculation of charges restriction for distributed generation and registered power zone incentives**

The licence draft appears to omit investment for the year 2005/06. In accordance with the Price Control Review Final Proposals the calculation of the term  $GP_t$  should be revised to remove this omission.

Paragraph 8 states that the licensee may exclude capex in respect of certain assets but does not appear to deal with the asset value so excluded. We understand that this value should be added to the RAV as an asset transfer and, as such, the transfer should be stated explicitly.

**E1: Charge restriction conditions: supplementary restrictions**

The assessment of the level of under/over recoveries, for the purposes of paragraphs 4 and 6 should apply to each of the two successive years and not to the cumulative of the two successive years as may be interpreted from the original drafting. This ensures that any significant variance in any one particular year does not overly influence the assessment. This is particularly important as applied to the restriction on generation charges as there is likely to be significant volatility in distributed generation connections and associated forecasts over the first few years of the application of generator shallow connection and use of system charges.

**F1: Restriction of basic metering charges**

Paragraph 7 of the draft licence condition requires charges to be set for each meter type (excluding single phase single rate credit meters and single rate prepayment meters). However, the drafting does not define the "type" of meter and hence the requirement to undertake individual meter type pricing could be construed to include each and every model type produced by each manufacturer that is purchased by the licensee. We believe the intention is to ensure cost reflective charges for each type of meter 'functionality' rather than manufacturers model type. The types of functionality which should be included are: multi-

rate single phase credit meter, multi-rate prepayment meter, single and multi-rate polyphase whole current meter and non half-hourly current transformer operated meter. The limitation of the definition of “type” to the functionality as described above would provide both cost reflective charges of sufficient granularity as is current practice and be in line with the charging approach taken in paragraphs 3 to 6.

### **SLC 1: Definitions and Interpretation**

As currently drafted the definition of the “distribution business “ excludes the provision of metering services, whilst the definition of “distribution business activities” includes metering services. In addition, standard licence condition 43 prohibits the licensee from conducting any business other than the distribution business (i.e. excludes metering). We believe the definition of “distribution business” should include the provision of basic metering services in accordance with standard licence condition 36.

### **SLC42: Regulatory accounts**

We question the proposed obligation on businesses to use “best endeavours” to ensure the audit profession comments that the discrimination and cross-subsidy requirements of the specified Directives have been reported. The proposal should be modified to limit the obligation on the licensee to “take all appropriate steps within its power”.

### **SLCs 49 to 51: (Incentive schemes and associated information)**

It is necessary to ensure the RIGs remain limited to providing necessary information relevant to the operation of the appropriate incentive scheme, as we believe Ofgem intended and is mentioned in paragraph 12, 13 & 12 of standard licence conditions 49, 50 & 51 respectively. However, we have a concern that the change control process for the RIGs is not sufficiently robust (as currently drafted) so as to limit the expansion of the RIGs from specifying additional information gathering over and above that which is necessary for the incentive scheme, without the necessary agreement of the licensees. We therefore propose that the change control process is more clearly defined in conditions 49 to 51 so as to require changes to the accuracy of information or the introduction of additional categories of information to be subject to the procedure under section 11A of the Electricity Act 1989 as specified for changes to licence conditions. We fully support the drafting modification as proposed by the ENA.

### **SLC 50: Price control revenue reporting and associated information**

The current draft introduces an obligation on the licensee to restate the audited regulatory returns where information is found to be incorrect subject to the change exceeding a materiality threshold of 1 per cent of base revenue. This obligation is likely to present significant problems with reconciliation to regulatory accounts and increase the burden for licensees to further ensure audits are repeated, perhaps even several times over a number of years. It is recommended that the obligation be modified to allow the licensee to determine the most appropriate action as is currently in place i.e. to include adjustments in the year they are discovered or to restate returns.

**SLC52: External revenue provision**

Special licence condition 52 limits the obligation to maintain price control review information to the licensee and any affiliate or related undertaking of the licensee. However, in order to establish standard percentage weights for allocating indirect costs across activities, it is important that the balance between direct costs and support costs are recognised for each activity regardless of whether the function is provided internal or external to the Group. It is potentially distorting to ignore the 'indirect costs' included in a contract with a third party, especially if these same costs would have been picked out of a contract with a 'related party'. We believe the licence condition should include external service providers within the obligation to maintain price control review information.

**Quality of Service, Distributed Generation and Revenue Reporting RIGs**

As stated above, we support the ENA response to Ofgem regarding the RIGs. We do not have additional UU specific comments.

**Process**

We understand that Ofgem propose to reissue a further draft of the Licence conditions, complete with licensee specific data, by the end of January. We welcome the opportunity to review and comment on the licence modifications before the section 11 notice is issued in mid February.

We would also welcome a further draft of the revenue reporting and distributed generation RIGs in February following Ofgem's consideration of the points raised in the ENA response before the publication of the final versions for application from 1 April 2005.

If you require clarification of any of the issues raised in this letter please do not hesitate to contact me.

Yours sincerely

Mike Boxall  
Head of Electricity Regulation

cc Colin Green  
David Young  
James Hope