

Laing Energy

Consultation Response Paper

**Regulation of Independent Electricity Network
Operators**

**Ofgem's Initial Proposals Document (January 2005
18/05)**

Introduction

Laing Energy welcomes the opportunity to further comment on the consultation into the regulatory arrangements for IDNOs and for DNO's providing services outside their distribution service area with respect to:

- charging arrangements;
- financial ring fencing conditions; and
- commercial issues

Laing Energy is broadly in favour of Ofgem's initial proposals to:

- establish a relative price control framework for a review period of ten years where IDNO charges continually follow the incumbent DNO charges subject to pre-determined floor and ceiling
- to maintain the basic approach for alternative arrangements to the requirement for an investment grade credit rating under licence condition BA of the IDNO licence

Laing Energy also welcomes the opportunity to develop thinking on the commercial framework for IDNOs with respect contractual arrangements, metering and quality of supply.

Our detailed comments are as follows:

Charging Arrangements

Laing Energy agrees that consumer benefits that may be gained through RPI-X regulation based on IDNO's costs would be outweighed by the regulatory burden this approach would place on IDNOs and Ofgem. Laing Energy supports a simple form of relative price control with a starting point set to the incumbent DNO's charges for both domestic and non-domestic customers.

Ofgem has tabled two proposals:

- Option 1 - RPC based on incumbent DNO's charges
- Option 2 - RPI-X applied to IDNO's differential charge

Laing Energy supports Option 1 on the basis that:

- it is much simpler to implement and subsequently administer
- it would not lead to a significant divergence in charges
- it provides certainty for a period of ten years

However, if an IDNO's charges are to be set using the incumbent DNOs charge to equivalent domestic customers as a benchmark it is critical that the DNO charges are fully transparent, cost reflective and appropriate. Such charges need to demonstrate that the allocation of costs is not unduly distorted between connections to different customer classes or between connections at different voltage levels. Such charges

should not unfairly prejudice an IDNO seeking to make connections to a DNO network when compared to similar connections provided by the incumbent DNO.

This cost reflectivity should create an equivalent “level playing field” and take into account all items; for example, the fact that at present the IDNO will suffer the downside of items such as supplier bad debt risk.

Although we consider Option 1 appropriate in principle, we would appreciate seeing a number of worked examples. Whilst we consider the floor given in the proposal as workable, we believe that the ceiling (currently suggested as +5% (or +10% for years 6 onwards)) should be uncapped, or at least should be set at a much higher level than that of the floor (suggested as 25%).

Our reasoning for this is that increases in the revenue charges appropriate to an incumbent DNO will be almost exclusively driven by costs that are predominantly outside of the control of the DNO (or IDNO), for example Lane Rental costs, increased fuel charges, increased pass-through costs (such as rates, and licence fees); and, other exogenous factors such as London Weighting; We do not see such increases would be as a consequence of Ofgem allowing the incumbent DNO to become “more inefficient”.

Each of these cost increases will equally impact an IDNO. However, whilst the DNO will be able to recover many such increases through the price control mechanism, the IDNO would have no mechanism to recover such costs increased imposed on it through Option 1 proposals. We are concerned that as the asymptote of cost efficiencies becomes closer, that such upward pressures on charges will become more prevalent (as increased regulatory and environmental burden is placed on network operators) with the incumbent DNOs being protected whilst the IDNOs are at risk.

Our contention that the ceiling should be removed is especially relevant given that the gearing effect caused to the IDNOs DUoS share- this gearing caused by the fact that DNO upstream DUoS charges are likely to form a large percentage of the IDNOs total DUoS charge and yet it is this total DUoS charge on which the cap mechanism operates (as indicated in Figure 5.1 of Ofgem’s initial proposals document). The gas industry charging structure is arguably more transparent than that in electricity and we therefore see a divergence from the gas model.

Whilst we understand that there is reciprocity with regard to the floor, it is expected that DNOs will reduce costs and therefore the floor is relevant.

We presume that the mechanism or structure of charges developed regarding transparency and appropriateness of DUoS pricing will extend to ensure that any irregular pricing elements are excluded - such as the K factor applied to DNOs will not unfairly affect the DUOS pricing, and therefore unfairly affect an IDNOs starting point.

Laing Energy will be connecting both domestic and non-domestic customers at various voltage levels on a DNO distribution network. For this reason we believe it is also necessary to establish both upstream and downstream use of system charges at entry and exit points for each voltage band. In particular it is important that upstream charges are cost reflective at each voltage level. In Germany and Austria, use of

system tariffs are calculated at seven voltage levels to resolve this issue for connected parties:

The charges are calculated at the following entry and exit points on the distribution system:

- Level 1- connected to the VHV grid (220kV, 380kV)
- Level 2- connected to a VHV–HV transformer at 110kV
- Level 3- connected to the HV grid (110kV)
- Level 4- connected to a HV–MV transformer at MV
- Level 5- connected to the MV grid
- Level 6- connected to a MV-LV transformer at LV
- Level 7- connected to the LV grid

Laing Energy suggests that a similar UK model could be developed to calculate upstream use of system charges for each DNO for a range of connection points on the distribution network. This would provide a starting point for calculating the DUoS split and could then be factored to take account of site specific issues such as long cable route lengths. At present the only mechanism to resolve the issue of fair DUoS split appears to be through determination by Ofgem. If cost reflective charges were derived for each voltage level it would enable a fair split of charges for each DNO/IDNO, particularly where networks are “nested”. Laing Energy would welcome discussions with Ofgem to develop thinking on this issue further and for this issue to be dealt with through the Structure of Charges ISG.

The issue of supplier default risk remains outstanding; at present if a supplier defaults on an IDNO network then the IDNO carries the full risk whilst the DNO is not at any risk. Where suppliers default in respect of DUoS payments to a DNO Ofgem have indicated the DNO will be allowed to recover the bad debt as a pass-through charge. In their conclusions on credit cover Ofgem have not indicated what equivalent arrangements apply to IDNOs in this respect.

We believe that in respect of DUoS Charges the downstream distributor (DNO or IDNO) is acting as an agent for the upstream distributor in billing and collecting DUoS charges for the upstream network. This arrangement exists because electricity trading arrangements do not easily facilitate the adoption of the gas transportation model. Therefore, we do not believe that an IDNO should be liable for a defaulting supplier’s bad debt in respect of the upstream DUoS charge.

It is suggested that where DNOs are working outside of their distribution services area that they be regulated with respect to “out of area networks” in the same manner as IDNOs. We believe IDNOs are at a real competitive disadvantage when compared to DNOs working out of area. A large proportion of the DNO’s costs are already covered within their services area through the distribution price control, such as:

- MPAS services
- asset management and records
- IT systems
- system control facilities
- customer services
- billing
- operations and maintenance

- repairs

Laing Energy believes that it is inappropriate that a DNO, in respect of its activities out of area, should be treated on the same basis as an IDNO. The use of systems and resources that are essentially financed through price control income (from within a distribution services area) to provide services in respect of assets that are out of the distribution services area potentially distorts competition. Therefore, where a DNO establishes and operates assets outside of its distribution services area we believe that the costs and incomes should be included in the DNO's regulatory price control.

Three suggested dates are proposed for the review period; April 2005, September 2005 and April 2006. April 2005 is probably not now achievable, we would therefore suggest that September 2005 might be more appropriate; providing sufficient time to develop the final arrangements.

Financial Ring Fencing of IDNOs

Laing Energy believes that the alternative arrangements BA5 provide the financial safeguards necessary to protect customers from supply disruptions resulting from financial distress experienced by an IDNO. Laing Energy has spent considerable time, effort and financial resources developing its alternative arrangements to the satisfaction of Ofgem. Any changes to those arrangements would further increase our market entry costs. We would agree with Ofgem that the current alternative arrangements should be maintained.

Laing energy agrees that the licence modifications proposed as part of DPCR4 should be applied to the financial ring fencing conditions of IDNOs. We believe the trigger event for the cash lock up should be the failure of the parent to meet a call under the keepwell agreement.

Commercial Issues

Contractual Arrangements

Laing Energy has invested considerable time, effort and financial resources to develop a distribution business which works within the current industry framework. We are concerned that any major changes now could result in further significant start up costs for our business. At this time, it is not known what changes would be required to central systems and processes to move to the gas model. Until an initial feasibility study is carried out on this it is not possible to fully understand changes that would be required to systems and processes and what the costs of implementing such changes would be. However, our view is that such costs are likely to be much greater than the benefits. Therefore, we believe it is more appropriate to concentrate on addressing the risks and burdens under the current arrangements.

We believe there is a case for developing a common industry agreement for use between DNO and IDNO. This agreement could:

- define apportion upstream and downstream use of system charges
- apportion the risk associated with Supplier default

- guarantee the costs of connection
- guarantee the delivery programme
- detail joint operating and access arrangements

An area of key concern is the response of DNOs in providing firm quotations for the provision of connections and the subsequent provision of assets for the making of connections to an IDNO system. This is particularly the case in respect of EHV site specific DUoS charges. Delays in providing such information can significantly hamper an IDNO in making a commercial decision. We feel that it would provide greater clarity and transparency if the service levels for carrying such activities were documented in model industry agreements. We note that Ofgem has promoted the use of service level agreements for unmetered supplies.

Although access and operational requirements may be site specific and DNO specific we believe that there would be benefit if common industry model forms were adopted for access and operation of assets. We note that this is achieved through MOCOPA in respect of meter operators working at or on the boundary. We believe that the framework of this agreement could form the basis of an access and operational agreement

Boundary Metering

Laing Energy is not convinced that there is any technical, safety or commercial justification for investment in boundary metering. In addition, we have learnt through experience there are practical reasons why metering cannot be easily accommodated within distribution networks. An example is tabled below:

Project Details

Laing Energy is connecting at an existing 11kV primary switchboard. In order for the connection to be provided, it is necessary for the incumbent DNO to provide two refurbished circuit breakers to feed the embedded network and provide an agreed shared point of isolation.

The refurbished circuit breakers are Reyrolle Type C and we understand that it is not possible to make provision for metering within the aged circuit breakers. Therefore the host DNO requires further isolation and metering equipment to be established between the networks. There is no space for this equipment within the footprint of the host DNOs site. This equipment would therefore need to be sited within public space adjacent to the primary substation. We do not believe this is a practical solution for the following reasons:

- it adds significant additional costs to our scheme (£69,000)
- local authorities will not allow the development of these boundary substations

We noted during the course of the consultation workshop in February that the reasons put forward by the DNOs for boundary metering were to accurately record consumption at the boundary in the event there is a dispute on the level of consumption exiting Laing Energy's metering points and consumption consumed at the

boundary. Network losses and illegal abstraction were cited as reasons for a possible discrepancy.

We believe that modern Laing Energy networks, built to modern specifications will be more efficient in terms of distribution losses. In any case this is a calculation that can be easily calculated fairly accurately for each particular network.

Illegal abstraction is an industry issue which affects all parties. We believe this issue should be tackled on an industry basis and is not a risk that should be solely borne by the IDNO.

We also recognise that many DNOs allow unmetered connections to their networks as permitted by The Electricity (Unmetered Supply) Regulations 2001. Some of these connections are to licence exempt networks such as those used for lighting and communications on motorways. Consumption data for such connections is based on estimated data. In the case of IDNO connections the majority of the electricity transported across a DNO/ IDNO boundary would be derived from metered settlements data; only a small proportion of the data would be estimated.

Our preferred solution would be to use the current industry data flows to calculate the overall use of system charges and simply apportion the charges by a fixed percentage for each network based on the point of connection and voltage for each DNO. Both parties could receive the same flows over the data transfer network for reconciliation purposes. Development of a UK charging model at each voltage level as suggested earlier could be used to determine the percentage split of DUoS. This would remove the need for any metering or major changes to the current industry trading arrangements.

Isolation Equipment at DNO/IDNO interface

Laing Energy welcomed the opportunity to discuss the issue of boundary isolation equipment at the DNO/IDNO interface at the industry workshop in February. Laing Energy believes that IDNO's and DNO's should share points of isolation to avoid duplicating assets. This arrangement satisfies Regulation 6 of the Electrical Safety, Quality and Continuity Regulations, providing appropriate joint operating and access arrangements are in place. These arrangements are already in place across adjacent DNO boundaries. Furthermore, Laing Energy has already agreed with one DNO to share points of isolation and work together to develop joint operating and access arrangements, we believe this approach should be replicated with all DNOs.

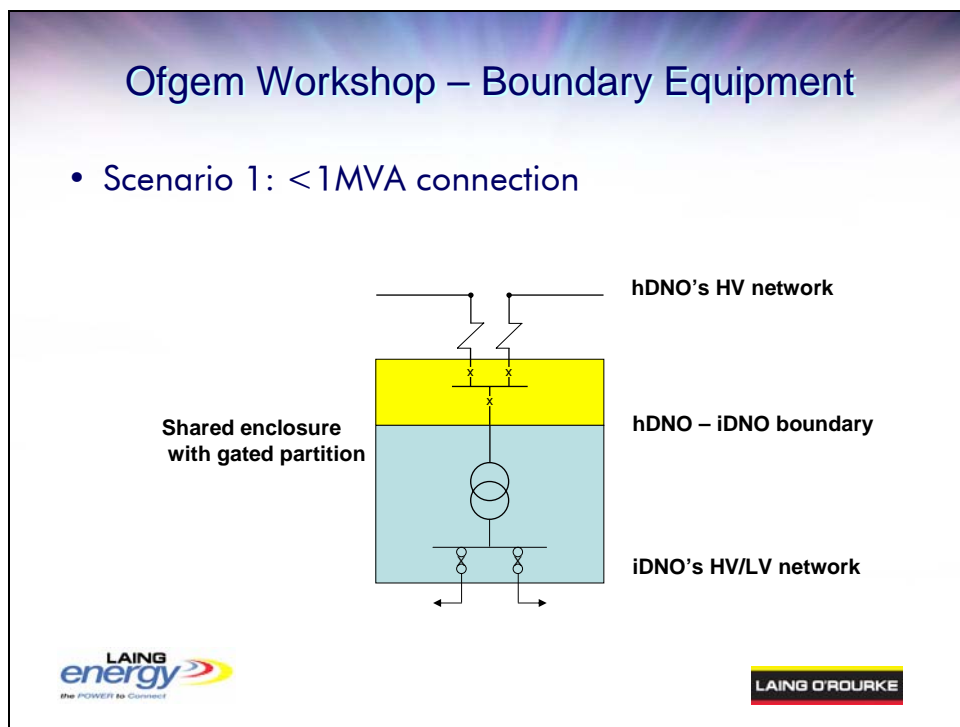
Our proposals tabled at the workshop are shown in Appendix 1:

Quality of Service

Laing Energy agrees with Ofgem that the same Guaranteed Standards of Performance should apply to DNOs and IDNOs. Laing Energy is of the view that where an IDNO incident or interruption takes place that affects downstream IDNO customers then the DNO should count all customers affected by the incident for the purpose of RIGs reporting and the IPP incentive scheme.

Appendix 1

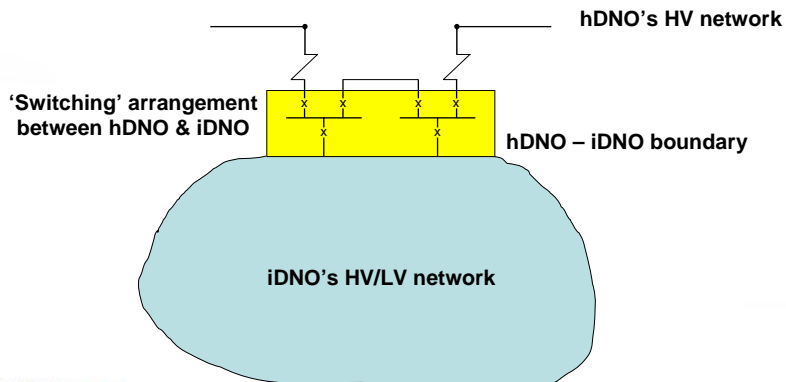
Scenario 1 (less than 1MVA) – New ring main unit connected into a DNO 11kV cable close to the site boundary. Suitable arrangement for a medium sized housing estate or small commercial development. The shared point of isolation at the boundary is the outgoing circuit breaker on the RMU fitted with suitable protection. A shared enclosure is provided for both parties, however one DNO has now agreed this is not necessary providing an appropriate agreement is in place to provide both parties with access for operational purposes.



Scenario 2 (greater than 1MVA) – New ring main units connected into DNO 11kV cables close to the site boundary. Suitable arrangement for a larger sized housing estate or medium sized commercial development. The shared points of isolation at the boundary are the outgoing circuit breakers on the RMUs fitted with suitable protection. A shared enclosure is provided for both parties providing an appropriate agreement is in place to provide both parties with access for operational purposes.

Ofgem Workshop – Boundary Equipment

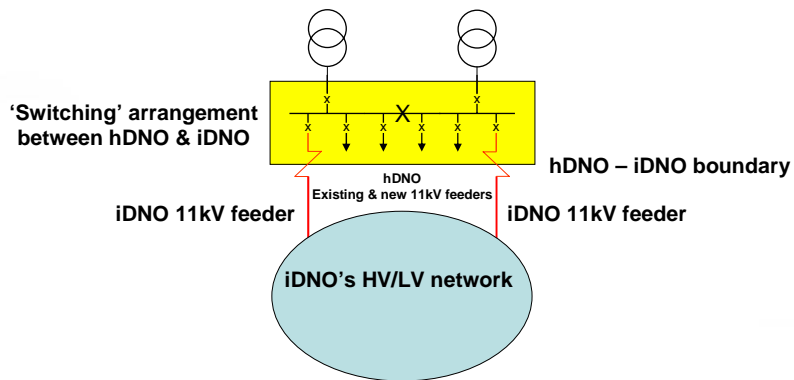
- Scenario 2: > 1MVA, < PSS connection



Scenario 3a (primary substation connection where spare capacity exists on the existing switchboard) – Point of connection is remote from the development. Suitable arrangement for a larger development. The shared points of isolation are the primary feeder circuit breakers fitted with suitable protection. Access is provided to both parties at the primary substation providing an appropriate agreement is in place to provide both parties with access for operational purposes.

Ofgem Workshop – Boundary Equipment

- Scenario 3a: PSS connection
 - spare capacity on existing circuit breakers



Scenario 3b (primary substation connection where spare capacity does not exist on the existing switchboard and there is no room for a switchboard extension) – Point of connection is remote from the development. Suitable arrangement for a larger development. The shared points of isolation are the outgoing circuit breakers on the RMUs fitted with suitable protection. Access is provided to both parties at the primary substation providing an appropriate agreement is in place to provide both parties with access for operational purposes.

Ofgem Workshop – Boundary Equipment

- Scenario 3b: PSS connection
 - NO spare capacity on existing circuit breakers

