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Sent via e-mail to: [mark.cox@ofgem.gov.uk](mailto:mark.cox@ofgem.gov.uk)

Dear Mark,

Re: Structure of electricity distribution charges – Consultation on the longer term charging framework

British Gas Trading welcomes the opportunity to comment on the above Ofgem consultation paper and is happy for this non-confidential response to be placed in the Ofgem library.

We are encouraged by the work undertaken to date and are supportive of Ofgem's review of the current structure of distribution charges. However, whilst we welcome the increased transparency that has resulted from this review, a number of issues have become apparent which we outline below, referenced using the headings and section numbering used in Ofgem's document.

#### General Comments

We believe that any charging approach adopted by the DNOs needs to be predicated on the fact that investment decisions relate to the future, not to the past. Accordingly, charges derived from the allocation of historic or existing costs will send potentially perverse signals. It is the estimates of future costs only that should inform future investment decisions.

With regard to scaling of charges, to provide DNOs their allowed revenue, we caution against the wholesale adoption of Ramsey pricing to minimise distorting economic signals primarily due to problems associated with identifying elasticity of demand.

As a major supplier which has been frustrated by historic DNO charging procedures, we restate the need for greater transparency, stability and predictability. One of the key improvements to the charge setting process would be to mandate that the industry has access to the models used by the DNOs to ensure the process of setting tariffs is as open as possible. We accept that whilst this may result in some short term disruption, the benefits in the longer term will be significant.

With regard to the tariffs, it is our firm belief that these should be available in an electronic format and/or via a website, rather than paper copies as is now the case for certain DNOs. We see this as a benefit to all parties as it would reduce administrative costs and errors to both the industry and the DNOs.

#### Detailed comments

3.13 Charging Models – We believe that of the five charging principles outlined, simplicity and transparency are the key ones and for these to be achieved as much detail of the models should be made available as possible.

3.35 Calculation of Costs – We support Ofgem’s assertion that charges should be based on the long run forward looking basis as this should provide the appropriate signals for future investment decisions. We also believe that short run costs are more relevant to decisions relating to consumption once the capacity has been installed.

3.59 We agree that demand and generation should not necessarily be treated symmetrically since factors additional to thermal capacity play a greater role in determining reinforcement costs for generation than for demand.

3.63 Locational variation - We are not convinced by the locational variation argument over a relatively small area. We support locational charging on a national basis, but given the DNOs have their own price controls, there seems little reason to further complicate an already complicated set of tariffs, to produce few benefits. It seems unlikely that locational pricing on a DNO basis will provide any meaningful signals to either demand or generation.

3.73 System load flow models - We do not support any model that is likely to add complexity to charging methodologies. The more complexity there is, the less transparency will result and the greater the chance that individual DNOs will adopt their own model.

3.84 Specific models advocated by the academics - All models should be available (on request) and understandable to all users of the system.

3.88 We cannot advocate the use of a model that relies on various assumptions to be made on a case by case basis and could therefore result in inconsistent decision making. We strongly support predictable tariffs.

3.89 We understand that the University of Manchester model is at prototype stage and have yet to see outputs to gauge how robust the model is.

#### Views invited

We are not in a position to support any one model as they all seem to have their shortfalls and there is limited information available on the models. Although we understand Ofgem’s rationale for not proposing to undertake a full impact assessment we would like to see Ofgem carry out some kind of comparison exercise, which could

be based on stylized network, for both demand and generation growth. This would enable the industry to gauge which model produces the most efficient and fair outcomes for customers and inform the cost benefits analysis of these proposals.

However, given the limited information we suggest that the preferred model should balance between cost reflective charging, simplicity and cost. It is unwise to introduce a fully economic model as this will not be cost efficient and is likely to be very complex.

## Chapter 4

4.5 We would advocate a shallower connection policy to ensure consistency with transmission connection policy. Additionally, a shallower policy prevents the "straw that breaks the camel's back" approach of a deep connection policy where one connectee becomes liable for infrastructure upgrades whereas prior connectees have been able to take advantage of available capacity on the system.

4.8 We agree with Ofgem that a review of DNO tariffs is well overdue in order to ensure that tariffs remain cost reflective. The regular review of DNO tariffs would be facilitated by a greater degree of transparency of these tariff methodologies. Although Ofgem cannot force DNOs to have the same methodology or indeed to restrict DNOs from making changes, the DNO should be under an obligation to justify the reasons behind changes.

4.13 Communication of Tariff Changes. We support the early communication of tariff changes. However, we would like to have the opportunity to comment on how this will work, who will be responsible for this and what timescale will apply. Transparency is a key requirement and communications should be electronic rather than via the manual postal systems still employed by some DNOs.

Line Loss Factors (4.14, 4.15, 4.16). We agree that there should be greater transparency in the calculation of LLF and the methodology should be published and factors subject to challenge/audit. We also question why ELEXON should manage the approval element of this process, its not robust and ELEXON admits that it does not have technical skills in this area.

4.21 We agree with concerns over Ramsey pricing and support the use of fixed adjustment as used in transmission charging described under 4.22. Furthermore, we believe it is important that any adjustment process needs to be transparent.

4.25 and 4.26 We believe that it is important that all users of the systems are kept informed and are fully aware of the potential "disturbances" created by the change in methodologies. It is essential that models are released and indicative tariffs are published **in a timely manner by all DNOs**. We also suggest that indicative tariffs are published at each stage and for all alternatives and that DNOs should be required to provide their prices electronically and preferably into a single central source; this improves transparency and efficiency.

4.25 Transitional Arrangements. We acknowledge that the introduction of new charging arrangements has the potential to lead to large disturbances in prices for some customers. However, we believe that Ofgem must minimise these disturbances

as there is strong evidence that customers prefer certainty and, from a supplier's perspective, there are significant cost implications associated with fluctuating charges.

4.33 Ofgem needs to ensure that all generators connected prior to April 2005 are treated on an equitable basis (across all DNOs). These generators paid upfront deep connection charges in the knowledge and believe that they were not liable for on-going use of system charges. Commercial decisions were made by these generators on this basis.

4.34 Historic Cost Adjustment. The text refers to 'either of these approaches would need to be developed in detail'. Obviously we could not support this until we were clear on the proposal.

4.36 We do not support the introduction of negative UoS charges. We suggest this causes perverse behaviour. In addition, it will result in separate rules depending whether a user is in a negative or positive area. This will add complexity to any methodology. We therefore support a zero cap for tariffs.

4.45 We agree that any potential impacts on the codes of practice should be reviewed as and when the requirements are clarified.

4.47 We believe that DNOs working together is a critical to providing consistent charging models.

4.48 Variation in Models across DNOs. We would not support this if the costs associated with managing innovative charging solutions were greater than the benefits.

4.53 Availability of DNO models. We support the disclosure of individual DNO charging models.

#### Chapter 5 and 6 General comments

Whilst we appreciate that Ofgem can only offer a view rather than initiating a project/policy, we suggest that the DNOs should all be producing a cost reflective model and methodology and as such should be encouraged by Ofgem to justify why their tariff model/methodology is different to other DNOs. If there are different reasons why certain DNOs should not work together on producing an overall model these reasons need to be communicated to the industry.

We support common charging methodology unless there is significant justification to the contrary. We believe that the benefits of this more than make up for potential drawbacks and offer a significant cost saving across the industry.

Timescales need to be aligned with industry knowledge and any DNO implementing a new model for 1st April 2006 should be releasing indicative tariffs shortly.

We support the continuation of the ISG albeit with revised terms of reference.

## Detailed comments

5.1 Whilst we recognize that the solutions to charging issues will ultimately be commercial rather than regulatory, we believe that Ofgem should ensure transparency and fair pricing being applied consistently to each of the DNOs.

Appendix 2, Losses:

First and second bullets. We support the adoption of a consistent methodology be adopted for the calculation of losses by all DNOs and publication of the methodology for calculating loss factors.

Third bullet. Large customers may need to have site specific losses and this should be considered fully during any further review.

Sixth bullet. We believe that there should be consistency between IDNs and DNOs.

If you wish to discuss any aspect of this response please do not hesitate to contact me on the above number.

Yours sincerely

Roddy Monroe  
Regulatory Issues Manager