National Grid Transco

Response to the Structure of Distribution Charges – Consultation on the longer term charging framework

Introduction

1. We welcome the opportunity to comment on the "Structure of Distribution Charges – Consultation on the longer term charging framework" (the consultation).
2. This response is in our capacity as the owner of the electricity transmission network in England and Wales, the operator of the GB electricity transmission network and the owner and operator of the GB gas National Transmission System.
3. Our comments draw on our experience of introducing and developing changes to locational charges and also cover those areas where there are interactions between distribution and transmission charging.

Comments on the consultation

Section 3: Use of System Charging Models

4. We agree with the view that the creation of new distribution charging models, which better reflect forward looking costs, incentivise efficient usage and development of the system, and accommodate the introduction of generation use of system charges better than the current models.

5. We support the principles identified by Ofgem and the Structure of Charges Implementation Steering Group (ISG) to be considered when developing charging methodologies: Cost reflectivity; Simplicity; Transparency; Predictability; and the facilitation of competition.

6. We believe that careful consideration should be given to the applicability of a charging model to both generation and demand. Although they can be similar in terms of the absolute affect on the distribution system, nevertheless generation and demand have very different business drivers and operating regimes. It may therefore be a more sustainable and robust approach to ensure that it is always possible to distinguish between generation and demand within the charging arrangements. This may not be the case if generation is "lost" as negative demand.

7. When considering forward looking costs, we note the discussion in sections 3.45-3.47 about the appropriate period over which future investment plans should be included in the model. The ISG concluded that one to five years would appear appropriate. Should tariffs be fixed for the same period as the planning horizon, (or fixed for any other reason) then the process for changing charges must also be considered as part of this consultation process. The longer the period over which the charges are fixed then the greater the probability that when prices are recalculated, that the step change will be much more significant. If charges are fixed for five years, then the process for

transiting to the new charges in five years time, including consideration of the appropriate notice period and any capping or smoothing, should be identified at this stage. If it is not, then when the time comes to introduce the new charges, views will be polarised amongst the winners and losers, making any meaningful consultation far from straightforward.

8. We note with interest the discussion on the use of National Grid's DCLF model in the calculation of locational prices for the EHV network. The DCLF transport model is applied to all transmission voltages in GB including 132kV and we see no reason per se why it could not also be applied to the EHV networks of the DNOs, much of which will also be at 132kV. With our experience with the development of the DCLF model across multiple voltages, one of the biggest challenges would be in the calculation of the expansion costs for each voltage and for different types of circuit, further complicated if this is over a number of networks. If the DCLF model were to be selected for use across all DNOs EHV networks then it would become possible to charge consistently across all these networks and at transmission voltages. Consideration should be given in this case to the inefficiencies of having 14 DNOs and National Grid Transco maintaining their own DCLF models, deriving their own expansion costs, evolving their own DCLF methodologies, and the overhead of making the model available to interested users. There may be merit in considering whether it would be possible for a single body to manage this process on behalf of all interested parties, a role which would be very similar to National Grid's position as GB system operator, setting charges for other parties' networks.

9. We fully support the views expressed in the consultation regarding consistency across transmission and distribution. This would clearly be achieved by the use of the DCLF model across transmission and distribution.

10. We would however suggest that care should be taken with the complexity of any model. Transparency is key, and the more complex the model the less transparent the charging arrangements will be perceived. Whilst there will always be a balance to be made between the key objectives for a charging methodology, such as cost reflectivity and simplicity, there would be benefit in developing a model which a user can obtain, understand and operate themselves. The more complex a model becomes the more scope there is to refine and improve elements of the methodology against the licence objectives, potentially making charges less stable and predictable. The suggestion of a model which relies on engineers to estimate the cost of installing and maintaining the network may not be perceived as either transparent or predictable, two of the principles identified as key features to be considered in the development of the new arrangements.

11. We note the suggestion of using another of National Grid Transco's charging models: Transcost. Out of the two charging models, Transcost and DCLF, whilst both have their unique merits, the simplicity of the DCLF model may be preferable for use on the electricity distribution networks. Transcost requires significant expert knowledge before it can be used to model charges.

Section 4: Detailed charging issues

12. If use of system charges are cost reflective we believe that a shallower connection boundary is preferable as this will facilitate competition in a number of ways, not least by removing barriers to entry.

13. Whilst we accept the difficulties of the structure of tariffs when considering how to adjust tariffs to ensure revenue recovery, percentage scaling of locational prices will result in the revenue recovery residual component of the tariff also being locational. A flat revenue recovery of component added to tariffs may therefore be more appropriate with locational charges.

14. We agree that any negative charges should be based on actual behaviour rather than expected behaviour. If a party is saving distribution costs by their behaviour then the must demonstrate their capability.

15. We note the comment in section 4.39 suggesting revised tariffs where a user has requested a lower level of security. It is important that this is linked to the connection boundary and that such user choice is limited to only those assets within the connection boundary. User choice is difficult to allow on use of system assets as by definition they are used by more than one user and the lower level of security would apply to more than one user. If user choice is limited to only connection assets then there is no need to revise tariffs as the user will have already seen the financial benefit in a lower connection charge.

16. Section 4.46 to 4.48 considers the issue of consistency of charging methodologies across DNOs. Diversity adds complexity for the industry and therefore may not be consistent with the objective of transparent, simple and predictable charging arrangements. As we have stated in earlier consultations, there may be merit in considering whether it would be possible for a single body to manage the charging arrangements for large sections of the distribution networks and potentially also across transmission and distribution. It is possible to de-couple the charging arrangements from the network owner, and this has been achieved already at transmission with National Grid Transco responsible for charging for use of the entire GB transmission system, large sections of which are not owned by National Grid Transco. Such an approach could ensure consistency and would also facilitate the management of interactions between transmission and distribution discussed in Section 4.49-4.51. There may however be additional factors to contemplate as a result of managing the commercial interface between the new entity and the DNOs. The commercial interface would need to consider a number of issues including the billing arrangements, information provision, credit, financial security and incentives.

17. We agree with the statement in Section 4.50 regarding the targeting of transmission costs on all the parties causing the costs. The current contractual arrangements do not allow National Grid Transco to establish a contractual relationship with all the necessary parties e.g. distributed generation below 50MW in England and Wales. DNOs do have the contractual relationship with all such parties. If the transmission charging arrangements were to change resulting in new charges being levied on DNOs then it would be necessary for

the DNOs to be able to charge such costs through to the users of their networks (in accordance with their own price controls and incentive arrangements). The DNOs would clearly need a mechanism to pass through such charges to the relevant parties, and we would welcome the development of a structure of charges that effectively facilitated such an arrangement.

18. It should be noted that a transmission user has raised a modification to the Connection and Use of System Code to clarify the rights of DNOs to export power onto the transmission system. This proposal is likely to require consideration of the charging implications and it is not inconceivable that this could result in changes to the commercial framework with new charges being levied on DNOs.

Section 6: Implementation

19. We note the discussion in Section 6 of the future role of the ISG. With National Grid's experience with locational pricing, with the issue of the interaction between transmission and distribution, and with some of our own models being considered, we would be happy to play a role in any industry group involved in the development of the distribution charging arrangements.