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Your ref. RBA/DPC/SOC

27 January 2006

**Consultation on Electricity Distribution Use of System Charging  
Modification Proposal: Central Networks – Excess Capacity Charges**

Dear Mark,

I refer to Martin's consultation letter dated 15 December 2005.

We welcome the consultation, and accept that it is beneficial to compare and contrast different approaches to excess demand charging as an aid to understanding. We would however respectfully point out the requirement for the Authority to reach its decisions based purely on whether or not Central Networks' proposal better facilitates achievement of its relevant objectives in the context of its own current methodology.

In relation to the particular issues on which your letter sought views, we would comment as follows:

**What costs are caused on the network by users exceeding their ASC?**

The proposed new methodology is based on the premise that the whole network must provide capacity, over and above that needed to meet authorised demand, to cater for the fact that authorised capacity levels will be exceeded by a proportion of customers spread randomly over the network. Our network design standards have been developed over the years in a world where excess demand is known to occur randomly across networks, and therefore these standards implicitly embody allowances for this.

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The main costs caused on the network by users exceeding their ASC are therefore incremental capital costs associated with making the network robust against reasonably foreseeable events of excess demand. There will from time to time also be costs associated with network damage caused by excess demand, (replacement fuses, etc), and there are also administrative costs associated with the ‘policing’ of authorised capacities, but these will be small in comparison to the incremental capital costs over the whole network.

**Does the proposed modification to the charging methodology and the approach proposed by CN for excess capacity charges reflect these costs?**

As described above, the use of excess capacity by customers causes incremental costs on the network, and we believe it is right that these costs should be apportioned onto those causing them.

The modification is based on modelling of the incremental cost of extra network capacity provided against the possibility that customers will exceed their authorised capacity level. In the absence of premium excess capacity charges, these costs would simply (and unfairly) be spread over all customers paying capacity charges, regardless of whether they exceeded their authorised capacities.

**As noted in Annex 1, there are different approaches taken by the DNOs to excess capacity charging – are these justified? For instance, what are the main drivers for differences between charging for 1 month as compared to 12 months?**

As stated earlier in this letter, the Authority should reach its decisions based purely on whether or not Central Networks’ proposal better facilitates achievement of its relevant objectives in the context of its own current methodology.

Having said this, we believe that there are a number of advantages to charging for excess capacity ‘within month’ rather than spreading the charge over 12 months. The main advantage is that price signals given in this way are more effective in driving the appropriate customer behaviour, as shown in the graph included in our proposal. Secondary advantages include greater certainty about capacity charges for suppliers taking on new

customers (which facilitates competition in supply), and administrative simplicity for both DNOs and suppliers (which reduces costs).

We are aware that a number of approved methodologies already include excess capacity charges of various sorts. It may be that the process currently being steered by the ISG will lead to a common approach to many charging issues, including excess capacity, but this is something that will be addressed in the future.

**Does the proposed modification better achieve the relevant objectives?**

We believe that the proposal better meets licence objectives by providing cost reflective charges for excess capacity. This type of charging has already been tried over a period of three years and has been demonstrated to modify customers' behaviour in a way that will reduce long run network costs.

By contrast to the above, our current method of charging for excess capacity (at the same rate as normal authorised capacity) effectively allocates part of the additional cost caused by customers that exceed, to all large customers. This provides little incentive for customers to control their demand, and unfairly penalises those customers that do not exceed their authorised capacity.

In addition to this major improvement to cost reflectivity, we believe the proposal will better facilitate competition in supply by giving suppliers greater certainty about capacity charges, and by reducing administrative costs for both DNOs and suppliers.

I hope these few comments are helpful to you.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Andrew Neves", is written over a horizontal line. To the right of the signature, there is a vertical red line.

Andrew Neves  
Tariff and Income Manager