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Dear Rachel

## Next steps in delivering the electricity structure of charges project

The Renewable Energy Association is on this occasion disappointed to have to comment on this consultation. It is most unfortunate that we are in the current situation and suspect this view is shared by many other stakeholders.

As you are aware our members work on all types of renewable power and heat projects and cost-reflective charging for the Distribution network is key to attracting appropriate forms of generation to locations near demand where its environmental benefits are increased.

As you will recall when we responded in August of last year we made a number of points including:

1. We supported a common charging methodology
2. We were not convinced either that the industry would or would not be able to agree on a common methodology. The essential point was that ***the industry had never been asked to develop a single methodology***. We therefore advocated that the industry be given until say the end of September 2008 to see if it could agree on a common charging methodology.
3. We did not understand why the methodology at HV / LV should be different to that employed at EHV. It may be that as a matter of expediency for HV / LV charges the methodology would be applied to a "typical sample network" or perhaps either a rural or an urban one rather than the actual network but the methodology could still be the same as for EHV. This would allow development of more network specific charging for HV / LV connectees at a later date if desired i.e. the use of a common methodology and application of that methodology at all voltage levels.
4. In line with 2 above we advocated a short period of further debate before deciding on the base methodology. In order to facilitate this and in the

absence of any other industry initiative we held a workshop for DNOs and generators on September 11th.

Whilst we cannot say what would have happened had our advice on giving the industry a chance to agree on a common methodology been followed in August / September our feeling is that views are now even more firmly entrenched and it would be even harder for the industry to reach a consensus, particularly as Ofgem has indicated its preferred approach.

Against that background we will now address the specific questions that you have posed.

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## **Chapter 2: Drivers for the structure of charges project**

**Question 1: In this chapter we highlight the key objectives for the structure of charges project and explain why these objectives are policy priorities for Ofgem. Do you consider that Ofgem is right to prioritise delivery of these objectives?**

There are four key objectives of the project that you describe and we comment on them in turn.

### **More Cost-reflective charging**

We agree with Ofgem that more cost-reflective charging for distribution networks is a priority.

### **A common charging methodology**

Whilst this would be ideal and Ofgem is right to try to achieve this, it is a lower order priority than having cost-reflective charging. The majority of economic benefit from the project will be delivered by achieving more cost-reflective charging. It is very difficult for us to quantify the benefit of a common methodology. If we were forced to name a figure we would say that for every generator considering new projects with a stable i.e. settled down charging background there would be an overhead of at least £1000 per year per methodology in use in areas where generation is being considered to maintain an understanding of the methodology. If the party wished to model how charges might develop under different scenarios the cost per methodology would be much greater as would be the case if major changes were being considered (as is the case at present). Having said this we still expect the major financial benefit of the project to arise from more cost-reflective charging rather than a common methodology per se.

### **A close deadline**

As for any improvement there is a benefit in implementing it as soon as possible. April 2010 is significant as it coincides with the next price control review period. We would not regard it as the end of the world if new charging methodologies (or a single methodology) were not implemented until say a year later in some or all areas. But it would not be acceptable for any delay in the implementation of new charging arrangements to affect the structure of the price control itself. The price control should assume cost-reflective charging and therefore the end of separate control of

generation and demand related expenditure, so as to allow negative charges for well-located generators without this being paid for by higher charges for other generators.

### **Common governance**

Common governance with the right of non-DNO parties to propose changes is important but clearly is not of the same priority as the other matters above and is in any event being addressed in another project.

**Question 2: Given the potential benefits of delivering the project for electricity customers, generators, distributors and suppliers, do you agree that it would be appropriate for Ofgem to continue to pursue delivery of the project?**

Clearly a conclusion has to be reached as to whether to have a common methodology and if so what and Ofgem has currently taken up the driving seat as to the process for taking this forward. It does therefore need to reach a conclusion on the process for achieving this.

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## **Chapter 3: Next steps in delivering the structure of charges project**

### **Introduction**

Starting from where we are (as opposed to where we might wish we were) it must be recognised that there is no way forward that does not have considerable downsides. It should be noted that in other fields DNOs have implemented common approaches without there being any requirement for them to do so. For example since 1990 there has been a common Distribution Code for England and Wales (which now covers Scotland as well) even though DNOs would have been quite entitled to have 14 separate Distribution Codes i.e. one each.

The REA does not see the DRM at HV / LV as the optimum solution for the long term. Therefore we would rather not see this approach enshrined in a collective licence modification. We would rather see DNOs agree to a single methodology voluntarily, as this gives greater scope for (what the REA sees as) a superior methodology to eventually emerge.

In any decision clarity is needed over the EHV component of the charges faced by HV / LV connectees. Presumably if different EHV methodologies continued (either temporarily or permanently) then it is only the HV and LV components of the charge that could be common, rather than the actual charges for HV / LV connectees that include an EHV component.

In terms of the end result that we would like to achieve our order of priority is

1. More cost-reflective charging to the extent that well-paced generators can receive a credit for the benefits that they provide to the network.

2. Achievement of 1 above as soon as possible and preferably from April 2010 but definitely not deferred until 2015.
3. Inclusive governance arrangements so that DNO customers (in our case particularly generators) can propose changes to the methodology or methodologies and are consulted at an early stage on changes proposed by others.
4. Minimum administrative burdens, ideally achieved by having as few methodologies as possible (ideally 1).

We recognise that other parties may have a different order of priority for example national suppliers may attach a higher priority to 4.

### **The fundamental question**

One could go around in circles listing the advantages and disadvantages of the various ways forward. In order to avoid this we think that there is a fundamental question that Ofgem needs to answer.

If there were no requirement for a common methodology would Ofgem ever approve a methodology if another was available and is use elsewhere which Ofgem felt to be superior?

If the answer to the above is "No" then this implies:

1. There must be a common methodology and
2. What the methodology is needs to be resolved

If the answer is "Yes" in that Ofgem might approve additional methodologies, provided they were each sufficiently cost-reflective / transparent / etc. then;

1. A common methodology is not essential (though it would still have advantages)
2. Methodologies would have to be judged on merit

Our feeling is that Ofgem would probably not accept a methodology if another one was available that it felt to be superior. Given this and the advantages of a single common methodology we will assume that the answer to the fundamental question is "no" and therefore the common methodology to be used must be resolved.

### **How to resolve the common methodology to be used**

The essential question is whether to go for an immediate Competition Commission referral on this issue or to give the industry some time to attempt to reach agreement. Our feeling is that an immediate Competition Commission referral would not be guaranteed to produce a result in time for implementation by April

2010 and therefore if one accepts that there may not be implementation of a common methodology before April 2011 there is time to give the industry one last chance to agree on a common methodology. We would like to reiterate (as we have been doing since last summer) that the industry has never been asked to develop a single common methodology.

It may of course be that the DNOs believe that the chances of agreement are so low that it is not worth devoting resources to the exercise. Our view is that if any DNO feels this way then immediate referral to the Competition Commission is probably the least bad option.

Our proposed way forward is therefore:

Give DNOs the option of agreeing a common way forward by the end of June 2009, in the absence of which the matter would be referred to the Competition Commission. If not all DNOs agreed to this way forward by say Friday 13th February, an immediate referral to the Competition Commission would be made.

If you agreed to this as a way forward you could say so at the beginning of February, giving DNOs two weeks to consider their positions. If all DNOs did not accept this then any referral to the Competition Commission would be delayed by at most one week compared to not giving them this option. If they did accept it then by the end of June the possibilities are that either:

1. DNOs have agreed an acceptable methodology and this could be implemented either in June 2010 or June 2011 or partly in each year or
2. DNOs have failed to agree and there would be a referral to the Competition Commission. Four months would have been lost compared to an immediate referral and this would make it certain that the full new charging methodology would not be introduced from April 2010. However it should be possible to introduce it by April 2011. It should also be noted that even an immediate referral to the Competition Commission may result in a common methodology being in place by April 2010.

If Ofgem goes down this route it should establish with DNOs whether a licence change would be required at any stage, along with . Ofgem would also have to discuss with DNOs either an agreed licence change or an agreement without a licence change. This should cover common charging for the HV and LV components of charges as well as a common governance mechanism.

Either way cost-effective charging should be introduced no later than April 2011 and this should allow Ofgem to base the price control structure for 2010 to 2015 on the assumption that all DNOs have got cost-reflective charging in place for a minimum of four of the five years of the price control period. In addition it will be known before the start of the price control period that fully cost-reflective charges are being introduced at the latest after one year, therefore parties thinking of establishing new demand or generation facilities will be aware of the situation before the start of the period.

Turning now to the specific questions on chapter 3:

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**Question 1: Do you consider that it would be appropriate for the Authority to refer the package of measures consulted on in our October proposal for a ruling by the CC? On this question we invite generators, suppliers and customer groups to confirm which aspect of our October decision would deliver the greatest benefit to them, and where possible to quantify this benefit.**

We consider that it may be a matter that should be referred to the Competition Commission but only after DNOs have either refused to work together to try to agree on a single methodology or have failed to agree on such a methodology. As discussed earlier we suggest they are given until the end of June. Immediate referral to the Competition Commission is not guaranteed to produce a result that could be implemented any sooner and this approach has potential to avoid a referral.

We have indicated above (in discussion under heading *Chapter 3*) the relative importance that we attach to cost reflectivity, timeliness, commonality of methodology and governance.

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**Question 2: Do you consider that it would be more appropriate for the Authority to modify the October proposal by excluding the requirement for a common charging methodology at EHV level, and opening a CLM statutory consultation on a modified proposal to deliver commonality at HV/LV level only?**

Our understanding is that the DNOs would be happy to implement common arrangements for the LV and HV components of charging (and possibly common governance) although this may cease to be the case if they also have to deal with a Competition Commission referral. We have no view as to whether a collective licence modification would be necessary to achieve this.

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**Question 3: If you agree that it would be appropriate to consult again on a modified CLM proposal at HV/LV level, do you consider that it would be appropriate for Ofgem to refer our October decision to implement a common LRIC methodology at EHV level for a ruling by the CC? If you do not agree that it would be appropriate to refer our LRIC decision to the CC, what option would you recommend to Ofgem to deliver revised charging methodologies at EHV level?**

If there is to be an immediate referral to the Competition Commission it is not clear that the limited collective licence modification would be accepted. Having said that, if after a set period it became obvious that referral to the Competition Commission was the only way to achieve an acceptable EHV methodology then this course of action would appear inevitable.

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**Question 4: Are there options we have not considered for ensuring delivery of the structure of charges project, if so what are they?**

We have described our preferred course of action earlier. In summary it comprises:

- Give DNOs until February 13th to undertake to work together to come up with an agreed methodology by the end of June
- If they do not do this, then refer the matter to the Competition Commission
- If no methodology is agreed by the end of June, refer the matter to the Competition Commission

The extent to which HV / LV charges can be agreed voluntarily and secured, if deemed necessary, via a collective licence modification in parallel with this we leave as an open matter.

Please let us know if you would like to discuss any aspects of this letter further.

Yours sincerely

Gaynor Hartnell  
Director of Policy.