British Gas

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Submitted by e-mail to: distributionpolicy@ofgem.gov.uk

Dear Ynon,

Electricity distribution structure of charges project: DNOs' proposals for a common methodology at lower voltages

1. British Gas welcomes the opportunity to respond to this important consultation document. We strongly support the implementation of a common methodology for distribution charges at lower voltages. We believe this will deliver major benefits for suppliers and customers, and provide much needed improvements in the transparency and predictability of distribution charges.
2. As set out in our response to the ENA's consultations on the CDCM in June and July, we consider it important that the CDCM is delivered as completely as is possible (across all regions) by April 2010. Implementation of the CDCM in line with DPCR5 will enable suppliers to manage uncertainty more effectively by combining what are likely to be significant price changes into a single event.
3. Whilst we are disappointed to see a number of derogation requests submitted by the networks, we can manage the impact on our systems as long as we are kept updated on developments and receive plenty of notice ahead of upcoming changes.
4. We have also identified a number of significant concerns on aspects of the proposals to introduce charges to generators connected pre-2005. These concerns are outlined more fully below.
5. In this response we set out our views on those additional issues in the consultation we consider to be most significant, these being:

- potential phasing of charges;
- treatment of operating expenditure;
- allocation of costs between unit, fixed and capacity charges;
- revenue matching;
- generator charging from 2010; and
- excess capacity charges.

Phasing of charges

6. We support Ofgem's "minded-to" decision not to phase charge changes that result from the introduction of the CDCM. We recognise that moving from the current system of complex charging to a single unified methodology will result in a reallocation of charges between customer categories in some locations. However, we believe that the introduction of the CDCM will deliver major benefits in terms of transparency, and as such should be introduced in full as early as is feasible.
7. We also note that the proposals themselves have been subject to numerous rounds of detailed consultation by both the ENA and now Ofgem. As such, the changes that will result from the CDCM have been well understood by stakeholders for sometime, and as such, it is difficult to believe that a phased introduction of the changes is warranted.

Treatment of operating expenditure

8. We strongly believe that fixed costs should be excluded from the charging model, with only those operating costs that clearly vary in line with network size being included. We therefore welcome the proposal to exclude an element from the charging model on the basis of these being fixed costs. At present, 26.5% of operating costs have been excluded from total operating expenditure, and on the basis of analysis presented by the networks we believe this proportion is reasonable. However, we would hope that the proportion of operating costs excluded is subject to open governance arrangements.

Revenue matching

9. An important element of any network charging methodology is the way in which modelled costs produced for each network match the revenue level the network is allowed to recover. We recognise that there are a number of methodologies that could be applied to achieve this. However, in principle we believe that the most appropriate method should be one that is simple, and which minimises distortions in the calculation of charges.
10. Although we also believe an annuity scaler as originally proposed by the networks has merits, on balance we agree with Ofgem's view that the £/kW "fixed adder" method of matching revenue is appropriate. We believe that this

approach is relatively simple and transparent, further promoting clarity and predictability in network charges. We are also encouraged that this methodology will be subject to open governance arrangements.

Generator charging from 2010

11. We have very significant concerns over the proposal to extend DUoS charges to pre-2005 generation connected to the distribution network from April 2010, and more specifically the methodology proposed by WPD for EHV connected generators. We recognise that the CDCM is at this stage focused on charging for HV/LV connected generation, however we raise these points in this response given the interrelated nature of the issues being addressed by the EHV and HV/LV CDCM processes.

12. In summary, we strongly recommend that Ofgem suspends WPD's introduction of charges to EHV connected generators from April 2010, until full industry consultation on the issue by the ENA has reached a conclusion.

13. WPD's proposed rates for 2009/10 are for a charge of up to £7m on Centrica's 230MW power station at Barry in South Wales. We believe this charge is not cost reflective, and if implemented would create major distortions to commercial incentives, potentially leading to inefficient investment decisions. Instead, we request that changes to the distribution charging regime for EHV connected generators should only be implemented from April 2011 once the ENA's consultation on a common methodology has reached a conclusion.

14. Barry is located close to the transmission network, and interacts with National Grid largely in the same manner as a transmission connected generator. Were WPD to implement its proposed charging regime, it would place a strong perverse incentive on Barry power station to invest in a 275 kV line of about 15 km at a one-off cost of roughly £8 million to connect directly to the transmission network, thereby avoiding annualised charges of up to £7 million. This would clearly be inefficient from an economic perspective, and be a direct consequence of the perverse incentives of the distribution charging regime. The resulting stranding of assets on WPD's network would also be to the detriment of customers who would be required to continue to pay for the (now underutilised) DNO assets.

15. We also believe that WPD's proposed application of charges to Barry is inconsistent with arrangements in the gas sector. In gas distribution, large loads that are connected within a few kilometres of the NTS are allowed to claim an optional tariff which avoids "perverse incentives for the construction of new pipelines when LDZ connections are already available[1]." We believe this represents a clear precedent for the treatment of Barry, and suggest that this should be properly considered as part of the ENA's industry methodology review.

Excess capacity charges

[1] See the charging methodology statement for London LDZ.

16. Breaches in agreed import capacities may have significant implications for network security. We agree it is important for DNOs to address such breaches, and therefore support the proposals set out for charging half hourly settled customers who exceed their agreed import capacity. However, we would reiterate it is also important for DNOs to ensure that such breaches are also discouraged by non-charging measures (so as to reduce the perception that by levying charges for breaches, these are in some sense legitimised). Therefore, we suggest that the wider consequences for customers that overrun agreed import capacities (and hence contravene their connection agreements) should be set out in full by DNOs, and enforcement be viewed as a credible threat by connectees.

Other issues

17. We note that CDCM proposes excluding replacement costs – and we continue to support this as an appropriate approach. We agree with Ofgem that replacement costs are already captured as part of price control revenue and as such the scaling element of the charge should fund the replacement of assets.

18. We also note that the CDCM models have assumed a fixed rate of return of 6.9%, despite the fact that this is in fact a variable, determined through the price control process. To the extent that the rate of return is material to the outturn level of charges calculated by the models, we would expect this to e subject to open governance arrangements.

19. Finally (and as mentioned in our response to the ENA's consultation), we are disappointed that DNOs felt they were unable de-link domestic tariffs in time for April 2010. In particular, we hope that the failure to de-link domestic tariffs should not prevent suppliers from offering innovative tariffs to customers where they want to install Smart Meters. It is also critical to capturing the full benefits of smart technology that charging structures enable us to offer new and flexible products to our customers rather than acting as an obstacle.

We hope that our comments will be helpful to you and your team.

If you have any queries and would like to discuss them further, please do not hesitate to contact me.

Yours sincerely

Philip Davies
Director of Regulatory Affairs