



To distributors, suppliers,
generators, customers and other
interested parties

*Promoting choice and
value for all customers*

Our Ref: 2/10
Your Ref: WPD/Wales/West/016
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Dear colleague,

Date: 14 January 2010

Notice of intention to consult on Western Power Distribution's (WPD) modification proposal (WPD/Wales/West/016) to introduce changes to its charging methodology at extra high voltage (EHV) level from 1 April 2010; and

Consultation on Western Power Distribution's (WPD) modification proposal (WPD/Wales/West/016) to introduce changes to its charging methodology at extra high voltage (EHV) level from 1 April 2010

Distribution Network Operators (DNOs) have licence obligations¹ to have in place a statement of use of system (UoS) charging methodology, a statement of UoS charges and a statement of connection charging methodology and charges. The statement of UoS charging methodology outlines the method by which distribution UoS charges are calculated.

DNOs are required to keep their statement of UoS charging methodology under review and to bring forward proposals to modify the methodology that they consider better achieve the relevant objectives². Before making a modification to a statement of UoS charging methodology a DNO must submit to the Gas and Electricity Markets Authority (the Authority)³ a report that sets out its proposal to modify its methodology and states how the proposal better achieves the relevant objectives. The DNO then makes the modification unless within 28 days the Authority either directs the DNO not to make the modification or notifies the DNO that it intends to consult and then within three months directs the DNO not to make the modification.

WPD submitted a modification (WPD UOS015) report on 11 December 2009 that set out its proposals to modify its statements of UoS charging methodologies in respect of its South

¹ Standard Licence Condition (SLC) 13.

² The relevant objectives for both the connection and use of system charging methodologies, as contained in paragraph 3 of SLC 13 of the distribution license respectively are:

- that compliance with the use of system charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by the licence;
- that compliance with the use of system charging methodology facilitates competition in the generation and supply of electricity, and does not restrict, distort, or prevent competition in the transmission or distribution of electricity;
- that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its distribution business; and
- that, as far as is consistent with the sub-paragraphs above, the use of system charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's distribution business.

³ Ofgem is the office of the Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter.

Wales and South West distribution services areas (DSAs). On 21 December 2009 the Authority notified WPD in writing⁴ of its intention to consult on these proposals.

On 11 January 2010 WPD withdrew modification UOS015 and replaced it with a new proposal (WPD UOS016). The new modification report was submitted because the report for WPD UOS015 contained incorrect details of WPD's indicative charges. WPD UOS016 contains the correct indicative charges and there are no additional differences between the modification reports for UOS015 and UOS016.

In accordance with SLC 13.6, this letter is notice of our intention to consult with the industry on WPD's proposals. The letter also constitutes our consultation of WPD's proposals.

Background

WPD's proposals seek to make changes to its methodology to take account of the implementation from 1 April 2010 of both the Common Distribution Charging Methodology at lower voltages (CDCM)⁵ and the new Distribution Price Control (DPCR5)⁶ – which, amongst other things, removes an exemption that allows the DNOs to not charge pre-2005 distributed generators (DG) from paying generation distribution use of system (GDUoS) charges.

This modification proposal follows on from an earlier modification proposal⁷ that was vetoed by the Authority in September 2009 because the Authority was unable to consider that modification at that time, in advance of a decision on the CDCM.

In parallel the DNOs are working collectively on EHV-level charging⁸. We would be interested to understand the extent to which respondents would want to see the changes WPD propose in this modification also incorporated within the long-run incremental cost (LRIC) EHV distribution charging methodology (the EDCM) from 1 April 2011. Such a move would, for example, limit the need for a further step change in customers' charges when the EDCM is implemented, assuming WPD can go ahead with this modification proposal.

Summary of WPD's proposals

WPD proposes to make the following changes⁹:

- Remove the exemption that excludes EHV generators connected pre-April 2005 from paying UoS charges and introduce specific arrangements to ensure that there is no undue discrimination between pre- and post-April 2005 generators*;
- Introduce a capping arrangement to address the calculation of perceived excessive LRIC charges in certain circumstances*;
- Update references to regulatory cost of capital following the publication of the DPCR5 final proposals*;

⁴ This letter can be found on our website at:

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgMods/Pages/DistChrgMods.aspx>.

⁵ Our November 2009 decision to approve the CDCM subject to conditions is published on our website at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=533&refer=Networks/ElecDist/Policy/DistChrgs>.

Our December 2009 decision regarding DNOs' work on four of the five conditions is published on our website at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=543&refer=Networks/ElecDist/Policy/DistChrgs>.

The CDCM applies to charges at high and low voltages (HV and LV).

⁶ See our Final Proposals document on our website at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=346&refer=Networks/ElecDist/PriceCtrls/DPCR5>.

⁷ Modification reference WPD UOS 013, submitted to us on 26 August 2009. Our decision is available to view on our website at:

http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgMods/Documents1/WPD_UoS013_decision_letter.pdf.

⁸ This work is set out on the Energy Network Association's website at: <http://2009.energynetworks.org/edcm/>.

⁹ Full details of WPD's modification proposal can be found in the modification report which can be found on our website at <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgMods/Pages/DistChrgMods.aspx>

- Update the section entitled 'Reconciliation of LRIC and DRM output to required revenue' to ensure the calculation of the £/kVA revenue fixed adder remains effective;
- Remove the 10 per cent cap on generator charge changes;
- Update references to licence conditions; and
- Replace a large section on the requirements to have a UoS agreement and the terms in those agreements with a single reference to the Distribution Connection and Use of System Agreement (DCUSA).

* This latest modification proposal comes after our decision on the CDCM and DPCR5 final proposals, and incorporates three (asterisked) key differences in approach from WPD's earlier modification proposal.

It is the importance from a policy point of view and potential impact of the first two additional changes that led us to decide to consult on this proposal.

A more detailed description of the proposed changes can be found in **Annex 1** which also sets out the impacts of the proposal.

Views sought

The Authority has taken the decision to consult on the proposed modifications to help it further evaluate the extent to which they better achieve the relevant objectives.

However, we have decided against carrying out a formal impact assessment¹⁰ on this proposal. The impact assessment of this modification proposal is best looked at on a case by case basis rather than the approach we normally take where we look at the impact on different categories of customers. We consider that key affected parties have sufficient information and are in a better position to assess the impact on their business of these changes. We are available to discuss WPD's proposals with any parties that request this during the consultation period and are particularly interested in views on the impact on cost reflectivity and competition in generation. However, we consider that this consultation letter is a proportionate means of canvassing views on WPD's proposals given the materiality and targeted impact of the new changes being proposed since WPD's earlier vetoed modification proposal. We also note the short timescales for implementation specified in WPD's report and consider that it would be difficult for us to perform a well considered impact assessment in this time frame.

We are looking for views on:

- The extent to which the proposals are more cost reflective than WPD's current methodology¹¹;
- Whether WPD demonstrates that its proposals facilitate competition in generation and supply and do not restrict, distort or prevent competition in transmission and distribution¹²;
- The quantitative impacts WPD's proposals may have on you or other market participants; and
- Whether we have correctly captured the main issues raised by WPD's proposal.

Specific questions related to WPD's proposal are set out in **Annex 2** which discusses their proposal and a summary of the overall and individual impact of WPD's proposals on charges are set out in **Annex 3**.

We are also looking for early views on the extent to which WPD's proposals should be considered for incorporation in the LRIC EHV distribution charging methodology (the EDCM)

¹⁰ In accordance with Section 5(a) of the Utilities Act 2000.

¹¹ Standard condition 13.3(c) of the electricity distribution licence.

¹² Standard condition 13.3(b) of the electricity distribution licence.

for implementation by 1 April 2011. If elements of the proposal are unlikely to be captured in the common LRIC model being developed by DNOs we would like to understand what is likely to be proposed in such cases so that we can understand in advance the likely impacts at 2011/12 on WPD's EHV customers.

Responding to this consultation letter

Views are invited on these points from any interested parties, including DNOs, generators, suppliers, IDNOs, customers and their representatives.

The process associated with modifications to the charging methodologies is detailed within the electricity distribution licence (SLC 13). As the Authority's decision is time bound, please ensure that your comments are received by the date indicated so that they can be fully considered. Please note that it may not be possible to consider responses on this modification proposal that have been received after this date.

Views are invited by **11 February 2010**. We are allowing four weeks for consultation given the short timescales available as we are endeavouring to publish a final decision on this modification proposal in advance of WPD giving 40 days' notice of its final UoS charges taking effect from 1 April 2010 as required under the DCUSA. In light of the very short timescales, we encourage interested parties to submit their responses in advance of this deadline wherever possible.

Where practicable, responses should be sent electronically to Nicholas Rubin, by e-mailing distributionpolicy@ofgem.gov.uk. All responses will be held electronically by Ofgem. They will normally be published on our website unless they are clearly marked confidential. Consultees should put confidential material in appendices to their responses where possible. We prefer to receive responses electronically so that they can easily be placed on our website.

Copies of this document are available on our website under the distribution charging modifications area of work¹³. If you have any questions concerning this consultation document please contact Nicholas Rubin at nicholas.rubin@ofgem.gov.uk or on 0207 901 7176.

Yours faithfully,



Rachel Fletcher
Partner, Distribution

¹³ <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgMods/Pages/DistChrgMods.aspx>.

Annex 1 – Summary of WPD’s proposal

Introduction

WPD’s modification report, which contains details of its proposals, can be viewed on our website¹⁴. WPD proposes to make several changes to their methodology and these are set out below. For ease of reference we have split this annex between changes that impact on charges and changes that do not. We give an indication of the impact on charges of the proposal where relevant. The splitting of issues and the indication of impacts is designed to give further emphasis to the issues discussed in Annex 2 and to the questions we pose in that annex.

The overall and individual impact of WPD’s proposals on charges are set out in annex 3 below for information.

Changes that impact on charges

1. Remove the exemption that excludes EHV generators connected pre-April 2005 from paying UoS charges and introduce specific arrangements to ensure that there is no undue discrimination between pre- and post-April 2005 generators
 - There are currently 26 EHV generation customers across WPD’s South West and South Wales areas that connected pre-April 2005.
 - Pre-2005 DG connected on the basis of a deep connection charging boundary. In general this meant that generators were expected to pay all costs associated with reinforcing the existing network at the time of connection. Under this regime there was then no ongoing charge for using the distribution network. The policy encouraged generators to connect in areas where no wider system reinforcement was required. WPD have clarified that this was the case for the vast majority of their customers.
 - At the beginning of the current (DPCR4) price control the connection boundary was revised so that post-2005 connections were on the basis of a shallow connection charging boundary. At the same time, an exemption was granted to all DNOs from charging pre-2005 connected DG for GDUoS for the duration of the price control, i.e. to 31 March 2010.
 - If accepted by the DNOs¹⁵, from 1 April 2010 the next price control (DPCR5) will remove this exemption to facilitate the levying of UoS charges on pre-2005 DG where:
 - they did not pay deep connection charges; or
 - where contracts can be amended to pay compensation to those who did pay deep connection in return for an agreement to pay UoS charges; or
 - where deep connection charges were paid but where it can reasonably be assumed that the assets the DG paid for through the original connection charges are now attracting significant replacement costs which means the DG should now pay GDUoS.

WPD had considered continuing with its policy of exempting pre-2005 DG from GDUoS charges. However, WPD recognise that plenty of notice has been given to prepare for the expiration of the exemption and there is a need to treat all DG in light of requirements to charge and not unduly discriminate.
2. Remove the exemption that excludes EHV generators connected pre-April 2005 from paying UoS charges and introduce specific arrangements to ensure that there is no undue discrimination between pre- and post-April 2005 generators

¹⁴ See our website at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=655&refer=Networks/ElecDist/Policy/DistChrgMods>

¹⁵ All DNOs have accepted the price control in principle subject to the licence conditions reflecting the policy set out in our Final Proposals documents.

- In order to treat all DG fairly but avoid inappropriate or double-charging, WPD say they propose to exclude from DG's GDUoS charges all assets fully paid for through deep connection charges under the pre-2005 deep connection charging payments. These cover reinforced shared use assets and sole use assets. The impact of this in WPD's network areas is to exclude all sole use assets from the calculation of charges for pre-2005 DG.
- WPD believe that it is appropriate for the exemption of these assets to remain in place for the duration of pre-2005 agreements as these reflect the original payments for the use of the assets. Adopting this approach would mean that no pre-2005 DG would migrate to "full" GDUoS charging arrangements between April 2010 and 2011 because no pre-2005 connection arrangements expire in that period. In practice, the arrangements proposed by WPD will last until April 2011, at which point the new EDCM common EHV charging approach will supersede the charging arrangements that WPD's proposals intend to amend.

The impact of this element of the proposal is to exclude two branches from the calculation of one EHV site's charge, which would reduce the 2010/11 charge at that site by £1.09m¹⁶. This reduction assumes the change described below to introduce a capping of charges to the annuitised NPV of the asset is not implemented. If this change is implemented then the impact of excluding assets from the calculation of the UoS charge is to reduce 2010/11 EHV DG charges by £179k.

3. Introduce a capping arrangement to address the calculation of perceived excessive LRIC charges in certain circumstances

- In the course of working through the charges for pre-2005 DG, WPD identified that LRIC produces high charges when modelling highly utilised assets belonging to certain pre-2005 connected DG.
- In particular, the annuitised LRIC charges calculated for any customer for these highly utilised assets exceed the total annuitised Net Present Value (NPV) of reinforcing the assets.
- In WPD's view these high LRIC charges are inappropriate and therefore they propose to cap asset charges to the lower of the individual customer's LRIC charge or the annuitised total NPV of reinforcing the specific branch assets.

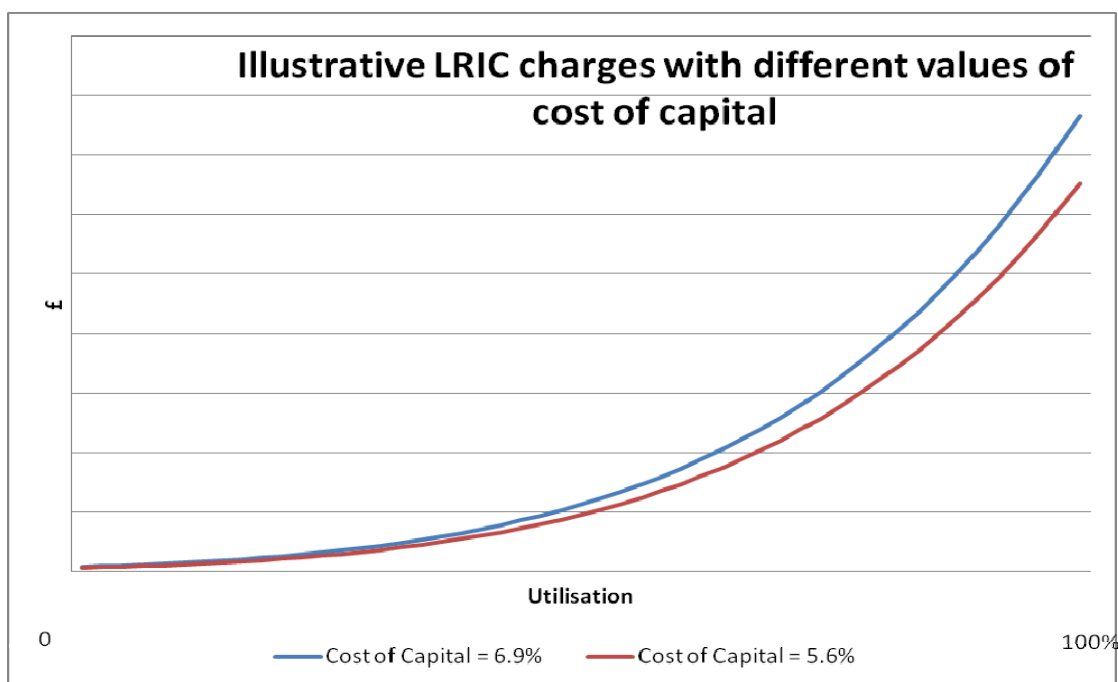
In practice, WPD's capping proposal affects 15 out of 1319 branches that are used to model the power flow impact of DG across WPD's two networks. This has the overall impact of reducing 2010/11 EHV DG charges by £1.51m or 42% from the uncapped LRIC level. This reduction assumes that the exemption to assets paid for through deep connection charges had not been implemented. If this change is implemented then the impact of capping charges to the annuitised asset value is to reduce 2010/11 EHV DG charges by £420k.

4. Update references to regulatory cost of capital following the publication of the DPCR5 final proposals

- WPD propose to change the pre-tax cost of capital used in their methodology from 6.9% to 5.6%. This is to reflect the cost of capital intended to take effect from the beginning of the next price control on 1 April 2010.

The illustrative impact of a change in the cost of capital on the LRIC charge for a branch at different utilisations is shown in the graph below.

¹⁶ As mentioned above, there are two site-specific customers connected to WPD's network that have assets that were reinforced pre-2005. However, LRIC charges are calculated by looking at branches. The assets associated with one of these customers are not taken into account when calculating a LRIC branch charge and so there is no impact on that customer's overall charge.



5. Update the section entitled 'Reconciliation of LRIC and DRM output to required revenue' to ensure the calculation of the £/kVA revenue fixed adder remains effective.

The proposed changes are two-fold:

- to use the definition of the 500MW model used in the CDCM to split revenue between EHV and HV/LV. Instead of using WPD's previous DNO-specific assessment of asset costs the CDCM approach has been applied. This approach increases the proportion of revenue recovered from EHV customers. This is because the new CDCM assumes all LV network is underground when in fact WPD's current 500MW model reflected that they have some LV network above ground. The CDCM approach also assumes that a third of trenching and reinstatement costs are included on LV networks, which is not in line with WPD's previous approach.

In their modification report, WPD do not set out the specific impact on charges as a consequence of using the 500MW model to split revenue. However they do identify the overall impact on the revenue split. In summary, the proportion of allowed revenue attributed to EHV usage increases by 1.5% points in WPD's South West region and by 2.6% points in its South Wales region.

- to apply no scaling to generators' charges. WPD consider that it is inappropriate to apply a fixed adder to the calculation of DG charges because overall their networks are demand dominated. If scaled, the fixed adder would be applied using winter peak demand. For DG this is the P2/6 assessed capacity (which is zero for wind farms). WPD have argued that not applying scaling to DG charges achieves the smallest impact on changes to charges.

By not scaling EHV DG charges, EHV DG customers should expect to see a total reduction in their charges of approximately £6.5m in the South Wales region and approximately £2.2m in the South West region against scaled charges. Demand customers' charges will increase as a result, however due to the number of demand customers, we consider that the impact on individual customers is not material.

6. Remove the 10% cap on generator charge changes
 - This was originally introduced in 2005 to prevent excessive volatility because at that time DG allowed revenue was very small and so subsequent changes in charges following the connection of new DG could be relatively large.

- The 10% cap is now being removed because it caused large and inconsistent differences between the modelled charge and the final capped charge.
- WPD argue that the cap would also result in distortions between the charges for pre- and post-2005 DG, which they believe would be discriminatory.
- WPD conclude that the cap can be removed in order to ensure consistency and cost reflectivity in charge setting.

The impact on DG charges in WPD's South West region is a saving of £30,000 and in their South Wales region a further saving of £58,000.

Changes that do not impact on charges

1. Updated references to licence conditions

- This is a simple updating exercise following the Distribution Licence Review (DLR), where new licence condition numbering came in to effect from 1 June 2008.

2. Replace a large section on the requirements to have a UoS agreement and the terms in those agreements with a single reference to the Distribution Connection and Use of System Agreement (DCUSA).

- This change is designed to avoid duplication and to simplify WPD's UoS methodology.

Annex 2 – Main issues with WPD’s proposal

On 26 August 2009 WPD submitted a modification proposal (WPD UOS013)¹⁷ that was intended to make changes to their methodology to facilitate the introduction of the CDCM and the new price control. WPD’s August proposal was vetoed in September 2009 because the Authority was unable to consider that modification at that time, in advance of a decision on the CDCM.

This current modification proposal follows on from WPD’s August modification proposal. WPD’s latest proposal has a number of new features and raises new issues in addition to those raised in the August proposal. Whilst we have already commented on the content of WPD’s original proposal, we welcome respondents’ views on the entirety of their revised proposal. We feel it is necessary to consult on the specifics of WPD’s proposal in order to give respondents the chance to comment on whether, and if so how, this methodology better achieves the relevant objectives.

In particular, we consider the key issues, which are new from the original proposal, concern the potential capping of outputs from the LRIC model and the proposed treatment of distributed generation that connected to WPD’s networks before 1 April 2005.

In addition, we consider that our comments on WPD’s original proposal remain pertinent to WPD’s current modification proposal. Therefore we have summarised these three sections again below. Specifically, this covers the sections concerning the recovery of allowed revenue, the removal of the 10% cap on DG charges and housekeeping changes.

Treatment of pre-2005 distributed generation

In our price control final proposals document¹⁸ we set out that the blanket exemption from use of system charges for generators that applied to generators connected before April 2005 (under the previous deep connection charging policy) would no longer apply from 1 April 2010. We are pleased that WPD has promptly brought forward a modification proposal to implement this new policy. Over the next few months we expect each DNO to update its UoS methodology to take account of this policy and set out what arrangements will apply for these generators.

WPD’s modification proposal updates its methodology to take account of the removal of the blanket exemption and sets out the arrangements to apply to pre-2005 generators.

In order to treat all DG fairly but avoid inappropriate or double-charging, WPD proposes to exclude from the calculation of DG’s UoS charges all assets fully paid for through deep connection charges under the pre-2005 deep connection charging payments. These cover reinforced shared use assets and sole use assets¹⁹.

We recognise that there may be cases where DG owners have paid for reinforcement of the network and the reasonable life of this original investment has not expired. For assets where this is the case, it may not be unduly discriminatory for there to be a period over which the DNO does not levy annual use of system charges on the DG. We expect the DNOs to be able to justify why charges should not apply on a case-by-case basis and to be

¹⁷ Modification reference WPD UOS 013, submitted to us on 26 August 2009. Our decision is available to view on our website at:

http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgMods/Documents1/WPD_UoS013_decision_letter.pdf.

¹⁸ See Chapter 4 of ‘Electricity Distribution Price Control Final Proposals’, Dec 2009 (Ref 145/09)

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=348&refer=Networks/ElecDist/PriceCtrls/DPCR5>

¹⁹ Typically, sole use costs are recovered through a fixed charge and represent the future cost of replacement and operation and maintenance (O&M) costs for the sole use assets. As part of the original connection charge, pre-2005 DG paid in full for the replacement and O&M costs of its sole use assets for the duration of the connection agreement. Therefore, WPD consider it would be inappropriate to double charge pre-2005 DG for their sole use assets.

able to demonstrate with credible evidence, including with reference to the age of the asset, that they are offering non-discriminatory terms.

We noted in our DPCR5 Final Proposals that even in circumstances where we agree it is not unduly discriminatory for the DG to be exempt from paying use of system charges, we think that it would be administratively simpler for Ofgem, the DNOs and all DG, if all the DG paid use of system charges on the same basis using a common methodology. This will remove any administrative burden (and the associated costs) on DNOs, DG and Ofgem to monitor the arrangements to ensure that DNOs are meeting their legal obligations not to discriminate unduly. In this respect, we set out in our DPCR5 Final Proposals that we would like to see DNOs explore whether they can refund the DG for the relevant proportion of their connection charges in return for paying use of system charges which provide a better price signal to DG about the impact that they are having on network costs²⁰. Where DNOs are successful in negotiating such changes to the contractual arrangements, and can demonstrate that it was appropriate to provide the DG with a refund on the connection charge, we propose to allow them to log up the compensation, which will then be reviewed as part of DPCR6.

We also note that whilst connection charges may have been paid in full many years ago, there might come a point where regardless of the payment of these charges, there is a case for DG to pay DUOS charges. For example, when assets paid for as part of the connection charge require replacement because their asset life has expired. Therefore, where a DNO decides not to levy use of system charges or make arrangements to modify the charges on the DG (eg similar to that which WPD have proposed), they must also demonstrate how they intend to manage the arrangements, and justify how long the arrangements will last, to demonstrate that they are meeting their legal obligations not to discriminate unduly. In WPD's case, they consider that their proposals should last for as long as a pre-2005 connection agreement is valid but in practice recognise that their proposed arrangements will only last until the EDCM is introduced in April 2011 and that in that time they expect that no pre-2005 connection arrangements or associated assets will expire or require renewal or replacement. We note it is not clear how the duration of the connection agreement varies between WPD's 26 pre-2005 EHV DG customers.

We invite views on whether the following appear appropriate and for respondents' assessment of whether the proposed capping method better achieves the relevant charging objectives²¹:

- *The use of the duration of the connection agreement to determine how long the exemption applies;*
- *The exclusion of all assets fully paid for through deep connection charges under the pre-2005 deep connection charging payments; and*
- *WPD's proposed approach overall (also bearing in mind the section below on capping).*

Capping of outputs from the LRIC model

WPD propose to cap individual asset charges calculated by its LRIC model where they are greater than the annuitised NPV of reinforcing the asset. They say that this is because certain pre-2005 DG connected at points of WPD's network with the intention of sizing their connection to take advantage of spare capacity. Consequently, certain assets associated to

²⁰ That is, DG will be better recognised under the more cost-reflective charging framework being developed as part of the Structure of Charges project – for more info see the relevant structure of charges documents on the Distribution Charges area of our website at

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Pages/DistChrgs.aspx>

²¹ See footnote 2.

the connection of pre-2005 DG are highly utilised and the charges calculated by the LRIC methodology exceed the annuitised NPV of reinforcing the asset.

In previous consultation and decision documents on the LRIC methodology, we have set out that we do not expect DNOs to apply the methodology 'blindly' where it appears to give counterintuitive or inappropriate results. We stated in our October 2008 decision document²² (paragraphs 1.25-1.26) that where this appears to be the case DNOs should:

- propose suitable alternative arrangements based on the DNO's best assessment of the long run incremental cost of providing capacity at a specific point on their network; and
- publish a clear explanation of the reasons for any adjustments and when they deliver more cost reflective charges at that location than the use of the LRIC model.

WPD's modification report sets out that it believes that its charges are inappropriate where the customer's annual LRIC charge for a specific branch in the model is higher than the associated annuitised total asset cost.

We note that capping could be argued to add additional complexity to the charging method. The use of an annuity under the capping method appears to tie LRIC to a method that notionally recovers total asset cost. This is not the stated aim of LRIC, which is designed to derive prices on the basis of the opportunity cost of adding an incremental power flow to an asset. Furthermore, the calculation and charging of the capped annuitised cost of an asset does not account for usage of the asset by multiple users. Therefore, where capping applies the annuitised cost of an asset may be recovered more than once because the cap is based on the 100% cost of that asset and is not apportioned to users based on their proportional use of the asset.

We invite views on whether the following appear appropriate and for respondents' assessment of whether the proposed capping method better achieves the relevant charging objectives²³:

- *the capping of charges;*
- *the point at which capping applies; and*
- *the use of an annuity to derive the capped charge.*

Updated cost of capital

WPD propose to calculate its charges in line with the DPCR5 cost of capital (5.6%). The illustrative impact of varying the cost of capital for one branch in the DG LRIC model is set out in annex 1.

- *We invite views on whether the cost of capital proposed by WPD is appropriate and whether this element of the proposal better meets the relevant charging objectives²⁴.*

Recovery of allowed revenue

²² Delivering the electricity distribution structure of charges project: decision document, 1 October 2008, ref 135/08, available on our website at: <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/Decision%20document%201%20October%202008.pdf>.

²³ See footnote 2.

²⁴ See footnote 2.

WPD's current EHV methodology uses a split of revenue based on the modern equivalent asset values (MEAV) of its lower and higher voltage networks. WPD proposes that the split of revenue will be determined using the 500MW model used in the CDCM.

This proposal impacts on charges because the current split of revenues between EHV and HV/LV is 36:64 in its South West area, which moves to 38:62 under the CDCM split. In its South Wales area the split moves from 38:62 currently to 41:59. Whilst the overall impact is that EHV demand customers will pay approximately 10% more, the impact of this on specific customers varies because of the combination of the locational incremental charge coupled with a £/kVA adder to reconcile to allowed revenue. For example, customers connected to parts of the network which have low or negative locational incremental charges but high demand requirements are much more susceptible to variations in the size of the £/kVA adder because the adder constitutes a much larger proportion of their overall charge.

WPD also proposes to remove the scaling of EHV generator charges. WPD states that it considered applying the same adder to both demand and generation but discounted this because the network is currently demand dominated and the fixed adder is applied at winter peak which would, they envisage, use P2/6 capacity which for wind farms would be zero. We do not necessarily agree that if there were an adder for generation that it would be applied in this manner but note, having reviewed WPD's analysis, that this approach appears to deliver minimal change in terms of pricing impacts on customers. Whilst not in their modification report to us, we have established that WPD's proposed removal of scaling generation charges to those customers charged currently would result in an overall decrease to charges of £224,000 in their South West region and a decrease in charges of £1.189m in their South Wales region.

Minimal change in charges for 1 April 2010 is important given that the EHV methodology may develop further under licence condition 50A²⁵ which will be effective from 1 October 2009 and will require DNOs to bring forward one of two common approaches for EHV charging by 1 September 2010, for implementation from 1 April 2011.

Removal of 10% cap on DG charges

WPD proposes to remove a 10% cap on generator charge changes. WPD explained that the cap exists currently to prevent excessive volatility in DG charge changes, which is a problem when scaling to a small allowed revenue. However, because from 1 April 2010, we propose that, as part of our DPCR5 Final Proposals, demand and generation allowed revenues will be combined, WPD considers that the cap will no longer be necessary.

We consider that the removal of the 10% cap would be a positive improvement to WPD's charging methodology in that it improves the cost reflectivity of charges.

We note that WPD has implemented a LRIC model at EHV which we anticipate will allow EHV demand and generation pots to be combined for charging purposes in the next price control period.

Housekeeping

In addition to changes to its method for recovering revenue, WPD proposes to make a number of consequential changes that are intended to ensure that its existing EHV UoS charging methodology continues to work following the introduction of the HV/LV CDCM and that references to licence conditions and the CDCM in its methodology are accurate.

WPD's updated references to licence conditions take account of the renumbering of licence conditions from 1 June 2008 under the distribution licence review project and as such this would represent an improvement to WPD's existing charging methodology.

²⁵ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=146&refer=Licensing/Work/Notices/ModNotice>

Annex 3 – Qualitative summary

Table 1 – South West - Summary of charge changes and impacts

South West	2009/10 Actual Charge	2010/11 Proposed Charge	Pre-2005 asset exclusion ²⁶	Cap to asset cost ²⁷	Cost of Capital ²⁸	500MW revenue split	Exclude DG from scaling ²⁹	Remove 10% DG charge change cap ³⁰
Demand								
Airbus (UK)Ltd	£216,858.18	£244,559.83	n/a	n/a	(£15,223.17)		n/a	n/a
Bristol Energy	£131,386.13	£131,965.01	n/a	n/a	(£5,029.99)		n/a	n/a
DML - DOCC3	£494,244.68	£363,508.16	n/a	n/a	(£15,207.84)		n/a	n/a
DML - DOCN3		£131,218.05	n/a	n/a	(£10,498.95)		n/a	n/a
Imerys Bugle Intake	£392,421.36	£34,196.31	n/a	n/a	(£1,905.69)	Overall impact is an increase in EHV allowed revenue of 1.5% points	n/a	n/a
Imerys Blackpool Intake		£8,782.63	n/a	n/a	(£486.37)		n/a	n/a
Imerys Drinnick Intake		£145,099.24	n/a	n/a	(£7,611.76)		n/a	n/a
Imerys Trebal Intake		£52,251.03	n/a	n/a	(£3,057.97)		n/a	n/a
Imerys Par Harbour Intake		£5,005.78	n/a	n/a	(£158.22)		n/a	n/a
Imerys Retew		£55,859.42	n/a	n/a	(£3,422.58)		n/a	n/a
RR Turbine Test		£33,235.44	£30,581.86	n/a	n/a		£96.86	n/a
RoF Puriton	£10,306.87	£6,438.80	n/a	n/a	(£393.20)	n/a	n/a	
Caberboard	£166,509.35	£133,019.96	n/a	n/a	(£4,828.04)	n/a	n/a	
SWW Tamar	£6,949.97	£11,392.07	n/a	n/a	£28.07	n/a	n/a	
SWW Roadford	£16,406.39	£19,949.59	n/a	n/a	(£278.41)	n/a	n/a	
St Regis	£133,262.23	£168,686.49	n/a	n/a	(£16,119.51)	n/a	n/a	
Tarmac	£51,487.27	£19,316.38	n/a	n/a	£575.38	n/a	n/a	
Langage	£56,449.08	£48,691.39	n/a	n/a	(£977.61)	n/a	n/a	

²⁶ Pre-2005 asset exclusion – this column represents the individual impact on the 2010/11 charge of excluding assets fully paid for as part of a pre-2005 connection agreement. A negative value represents a saving made by the customer as a consequence of the proposal.

²⁷ Cap to asset cost – this column represents the individual impact on the 2010/11 charge of capping individual asset charges to the annuitised asset value when the associated LRIC charge for the asset exceeds the annuitised value of the asset. A negative value represents a saving made by the customer as a consequence of the proposal.

²⁸ Cost of capital – this column represents the individual impact on the 2010/11 charge of changing the pre-tax cost of capital from 6.9% to 5.6%. A negative value represents a saving made by the customer as a consequence of the proposal.

²⁹ Exclude DG from scaling – this column represents the individual impact on the 2010/11 charge of not applying a fixed adder to scale EHV DG customers charges to facilitate the recovery of WPD's allowed revenue. A negative value represents a saving made by the customer as a consequence of the proposal.

³⁰ Remove 10% DG charge change cap – this column represents the individual impact on the 2010/11 charge of removing a cap on changes to GDUoS charges that exceed ±10%. A negative value represents a saving made by the customer as a consequence of the proposal.

	2009/10 Actual Charge	2010/11 Proposed Charge	Pre-2005 asset exclusion	Cap to asset cost	Cost of Capital	500MW revenue split	Exclude DG from scaling	Remove 10% DG charge change cap
Generators Pre 2005								
BEARS DOWN WINDFARM 33kV	£5,825.99	£2,496.90	n/a	n/a	£1,629.90		£0.00	n/a
BRADON FARM 33kV	£153,147.13	£43,013.07	n/a	(£4,809.82)	£3,699.07		(£106,430.62)	n/a
CARLAND CROSS 33kV	£1,744.82	£675.21	n/a	n/a	£429.21		£0.00	n/a
COLD NORTHCOTT 33kV	£4,342.62	£12,264.91	n/a	n/a	£2,796.91		£0.00	n/a
FORESTMOOR WINDFARM 1	£4.17	(£62.57)	n/a	n/a	(£54.57)		£0.00	n/a
FORESTMOOR WINDFARM 2		(£125.14)	n/a	n/a	(£109.14)		£0.00	n/a
FOUR BURROWS 33kV	£3,370.15	(£51.23)	n/a	n/a	(£4.23)		£0.00	n/a
HUNTWORTH GENERATOR 33kV	£145,487.85	£47,155.28	n/a	n/a	£5,615.28		(£155,267.41)	n/a
ISLES OF SCILLY 11kV	(£198,786.00)	(£160,868.05)	n/a	n/a	£16,978.95		(£77,685.46)	n/a
MARSH BARTON 132kV POWER STN	(£73,659.96)	(£232,929.08)	n/a	n/a	£65,443.92	Overall impact is an increase in EHV allowed revenue of 1.5% points	(£767,157.50)	n/a
ROLLS ROYCE FILTON 132kV	£59,524.19	(£1,802.48)	n/a	n/a	(£1,192.48)		(£828,092.79)	n/a
St BREOCK 33kV	£18,090.75	£9,178.78	n/a	(£6,919.59)	£508.78		£0.00	n/a
Generators Post 2005								
CONNON BRIDGE LANDFILL 33kV	£9,626.36	£3,247.61	n/a	n/a	(£657.39)		(£77,765.23)	(£5,416.12)
CHELSON GENERATOR 33kV	(£11,513.60)	(£11,887.66)	n/a	n/a	(£55.66)		(£29,992.49)	£0.00
DARRACOTT	£12,255.19	£5,355.86	n/a	n/a	£715.86		£0.00	(£5,673.81)
St Day	£1,503.87	(£5,046.17)	n/a	n/a	£1,599.83		(£47,594.64)	(£6,399.65)
Shooters Bottom	£11,642.04	(£2,464.95)	n/a	n/a	(£1,002.95)		£0.00	(£12,942.79)
Heathfield	(£39,389.33)	(£19,643.50)	n/a	n/a	(£1,940.50)		(£68,972.89)	£15,806.91
Goonhilly	£101,705.78	£76,224.31	n/a	(£110,612.39)	(£7,296.69)		£0.00	(£15,310.89)
DELABOLE 33kV WF	nil	£16,727.99	n/a	n/a	£3,393.99		£0.00	n/a
FULLABROOK WF	nil	£378,349.24	n/a	n/a	£39,928.24		£0.00	n/a

Table 2 – South Wales - Summary of charge changes and impacts

South Wales

	2009/10 Actual Charge	2010/11 Proposed Charge	Pre-2005 asset exclusion	Cap to asset cost	Cost of Capital	500MW revenue split	Exclude DG from scaling	Remove 10% DG charge change cap
Demand								
AES	£24,030.51	£102,740.47	n/a	n/a	(£7,958.53)		n/a	n/a
Alcoa	£114,819.51	£24,658.02	n/a	n/a	(£1,747.98)		n/a	n/a
Alpha Steel	£66,144.94	£17,298.77	n/a	n/a	(£1,050.23)		n/a	n/a
ASW 33/11	£391,396.44	£322,963.24	n/a	n/a	(£22,694.76)		n/a	n/a
ASW Rod Mill	£331,280.57	£396,748.39	n/a	n/a	£3,734.39		n/a	n/a
Blagden	£38,500.93	£106,272.10	n/a	n/a	£2,432.10		n/a	n/a
Blue Circle Cement	£84,369.39	£90,457.34	n/a	n/a	(£4,735.66)		n/a	n/a
Boc Margam	£1,211,290.10	£975,594.70	n/a	n/a	(£68,568.30)		n/a	n/a
British Alcan	£369,431.83	£261,314.95	n/a	n/a	(£18,610.05)		n/a	n/a
Corus Margam	£1,033,984.78	£659,170.71	n/a	n/a	(£40,645.29)		n/a	n/a
Corus Orb	£413,169.42	£416,171.51	n/a	n/a	(£25,632.49)		n/a	n/a
Corus Trostre	£650,789.16	£707,119.85	n/a	n/a	(£32,556.15)		n/a	n/a
Corus Whiteheads	£36,725.21	£31,506.95	n/a	n/a	(£542.05)		n/a	n/a
DCWW Nantgaredig	£9,445.47	£4,817.99	n/a	n/a	£27,378.99	Overall impact is an increase in EHV allowed revenue of 2.6% points	n/a	n/a
DCWW Rover Way	£312,815.95	£117,628.99	n/a	n/a	£110,005.99		n/a	n/a
Dow Corning	£77,774.20	£55,174.48	n/a	n/a	(£4,249.52)		n/a	n/a
Elf Oil	£868,661.68	£912,822.31	n/a	n/a	(£30,099.69)		n/a	n/a
Ford Bridgend	£417,216.54	£380,416.77	n/a	n/a	(£22,820.23)		n/a	n/a
Ford Swansea	£66,190.20	£57,537.43	n/a	n/a	(£3,356.57)		n/a	n/a
Fort James	£163,213.04	£156,711.20	n/a	n/a	(£16,696.80)		n/a	n/a
Inco (Europe)	£122,311.14	£137,495.61	n/a	n/a	(£10,159.39)		n/a	n/a
Mainline Pipelines	£46,941.92	£15,562.75	n/a	n/a	(£664.25)		n/a	n/a
Monsanto	£129,367.32	£122,319.40	n/a	n/a	(£7,075.60)		n/a	n/a
PCC Texaco	£1,324,847.80	£1,365,071.31	n/a	n/a	(£89,646.69)		n/a	n/a
Simms	£22,719.43	£9,064.88	n/a	n/a	(£454.12)		n/a	n/a
Swansea University	£47,806.61	£59,371.98	n/a	n/a	(£2,140.02)		n/a	n/a
Tower	£82,149.46	£11,040.88	n/a	n/a	(£355.12)		n/a	n/a
Whitbread Magor	£43,174.39	£50,124.16	n/a	n/a	(£3,094.84)		n/a	n/a
Dragon	£521,069.99	£39,860.43	n/a	n/a	(£1,428.57)		n/a	n/a
South Hook	£1,232,469.22	£173,182.94	n/a	n/a	(£3,371.06)		n/a	n/a

	2009/10 Actual Charge	2010/11 Proposed Charge	Pre-2005 asset exclusion	Cap to asset cost	Cost of Capital	500MW revenue split	Exclude DG from scaling	Remove 10% DG charge cap	
Cardiff Sports Village	£300,067.96	£70,222.67	n/a	n/a	(£2,861.33)		n/a	n/a	
Aberystwyth - Manweb	£1,321,431.04	£1,313,526.68	n/a	n/a	(£93,282.32)		n/a	n/a	
Velindre	£420,584.03	£493,817.07	n/a	n/a	(£36,557.93)		n/a	n/a	
Timet	£93,129.39	£93,550.14	n/a	n/a	(£6,807.86)		n/a	n/a	
Valleywood	£159,868.91	£1,479.99	n/a	n/a	(£36.01)		n/a	n/a	
Generators Pre 2005									
ABERAMAN PARK 33kV	(£16,136.99)	(£24,330.20)	n/a	n/a	£1,798.80		(£136,713.45)	n/a	
BLAEN CREGAN 66KV	£22,258.42	£137,868.80	n/a	(£70,521.06)	£9,967.80		£0.00	n/a	
BRITISH ENERGY 33kV	£854.91	(£5,163.85)	n/a	n/a	(£1,663.85)		(£136,713.45)	n/a	
BRYN TITLI W/FARM 66KV GEN	£6,655.37	£1,384.28	n/a	n/a	£856.28		£0.00	n/a	
CORNELLY 33kV	£47,879.75	(£19,669.81)	n/a	n/a	£3,701.19		(£140,861.44)	n/a	
CRYMLYN BURROWS 33KV	(£6,001.03)	(£8,107.74)	n/a	n/a	(£940.74)		(£76,187.08)	n/a	
DYFFRYN BRODYN 33 KV GEN	£67,834.38	£101,481.66	n/a	(£17,850.72)	£9,619.66		£0.00	n/a	
LLYN BRIANNE 33kV	£5,699.37	£22,545.79	n/a	n/a	£15,060.79		(£149,834.58)	n/a	
PARC CYNOG 33KV	£47,208.23	£87,203.81	n/a	n/a	£11,796.81		£0.00	n/a	
PWLLFA GWATKIN 33 kV	(£725.08)	(£7,462.55)	n/a	n/a	(£2,574.55)		(£81,774.13)	n/a	
SULLY 132kV	£4,232,594.53	£648,716.74	(£1,094,132.96)	(£1,246,407.10)	£60,572.74	Overall impact is an increase in EHV allowed revenue of 2.6% points	(£4,666,330.96)	n/a	
TAFF ELY WINDFARM 33KV GEN	£4,032.11	(£2.03)	n/a	n/a	(£2.03)			£0.00	n/a
TIR JOHN 6.6kV		(£4,110.51)	n/a	n/a	(£474.51)			(£38,480.31)	n/a
WATERSTON(GULF) 11kV 2 GEN BUS		£53,144.89	n/a	n/a	£3,772.89			£0.00	n/a
Generators Post 2005									
Trecatti	(£18,813.01)	(£13,965.33)	n/a	n/a	(£4,837.33)		(£54,652.20)	(£2,966.38)	
Withy Hedges	(£34,087.20)	(£24,519.71)	n/a	n/a	(£3,273.71)		(£29,514.87)	(£6,158.77)	
BOC Biomass	£95,987.54	(£19,361.70)	n/a	n/a	£4,029.30		(£201,838.31)	£105,750.48	
Blaen Bowi additional	£23,188.16	£180,133.68	n/a	n/a	£18,620.68		£0.00	(£154,626.71)	
Pendine Wind Farm		£112,350.36	n/a	(£1,750.89)	£15,957.36		£0.00	n/a	
Blaengwen		£664,381.69	n/a	n/a	£60,334.69		£0.00	n/a	
BETTWS GENERATOR 11KV		(£14,616.30)	n/a	n/a	(£1,718.30)		£0.00	n/a	
FOCHRHIW WF GENERATOR BUS		£6,279.19	n/a	n/a	£24.19		£0.00	n/a	
MAERDY WF GEN BUS		£20,294.65	n/a	(£54,848.42)	(£1,956.35)		£0.00	n/a	
NEWPORT BIOMASS 11KV		£48,374.32	n/a	n/a	£15,996.32		(£902,594.97)	n/a	