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Dear Chris,

Response to: "Electricity charging boundary between higher (EDCM) and lower (CDCM) voltages- Impact Assessment"; (ref:72/10)

We welcome the opportunity to comment on Ofgem's consultation "*Electricity charging boundary between higher (EDCM) and lower (CDCM) voltages- Impact Assessment*". GTC owns and operates licensed electricity distribution networks through its wholly owned 'IDNO' licensed electricity distribution business, The Electricity Network Company Limited (ENC). As such the margins available to us as an IDNO are significantly impacted by the charging methodologies employed by DNOs.

In addition to those responses we believe it is important to flag our concerns that the EDCM (LRIC or EDCM) may not deliver cost reflective charges to IDNOs. A methodology based on determining incremental reinforcement costs and scaling these to the allowed revenue may result in an inaccurate allocation or "smearing" of total costs (recovered as allowed revenue), and as a consequence, an inaccurate apportionment of costs in respect of IDNO networks.

Whilst we recognise that this consultation is about the charging boundary between the EDCM and the CDCM, we believe that such assessment cannot be separate from discussions on the cost reflectivity of the respective EDCM and CDCM. This is because the primary concern for most, if not all customers (including ENC operating as an IDNO), is about how the respective methodologies will impact the charges made to them.

At any connection boundary there will be a differential in charge a customer determined on a site specific cost basis and a charge determined on an average cost basis. Therefore, the debate is as much about the boundary between those sites where site specific tariffs should apply and those sites where generic 'average' tariffs should apply.

Our primary concern is whether a DNO decision on what methodology and/or boundary they apply in levying IDNO charges would disproportionately impact the margins made available to us.

Our responses to Ofgem's questions are provided in the annex to this letter.

Yours sincerely

Mike Harding
Head of Regulation
GTC

Annex

Chapter 2 Questions

Question 1: We welcome views on any aspect of the options presented in this chapter, and seek to understand whether any additional options or issues should be considered.

On closer consideration we support Option 2 (described as option RB by DNOs). We believe the boundary should refer to the voltage at the ownership boundary; i.e. the boundary at which the DNO system connects to the customer's assets, and not the voltage at which the metering is provided. However, we can see some merit to allow for HV connections, provided at the outgoing bars of an EHV/HV primary to be treated as site specific under the EDCM arrangements.

To allow HV connected customers to remain on an EHV tariff (as opposed to migrating to the CDCM generic tariffs applied to other similarly connected customers purely on the basis of facilitating lower charges would appear to be unduly discriminatory and amount to an undue cross subsidy from other customers. The same would be true if EHV connected customers were allowed to be charged on an HV tariff.

Question 2: We seek views on whether 'sole use' assets should feature in the definition of the boundary.

The key factor that should decide the boundary of the EDCM is the voltage of the distributor's assets (including 'sole use' assets) at the ownership boundary, not the voltage at which the customer is metered. Other than this we are not sure what relevance sole use assets have in the definition of boundary (assuming that sole assets are assets owned and operated by the distributor).

Question 3: We welcome views on how customers subject to 'special' metering arrangements should be treated in the definition of the boundary.

In the consultation (and in the workshop) there appeared to be confusion as to whether the boundary between the CDCM and the EDCM should be defined by the voltage that the connection is metered at or the voltage at the ownership boundary.

We believe that the boundary should be defined by the voltage at ownership boundary of the relevant assets. To do otherwise would be a significant flaw in charging arrangements. We urge that Ofgem provide absolute clarity on this point.

Both the CDCM and the EDCM are based on the costs that the distributor incurs in respect of the assets it owns. CDCM HV tariffs recover 'average costs' (as apportioned by the CDCM) of operating¹ each element of the network between a connection at HV and the grid supply point. If a customer, connected at EHV but metered at HV, is charged under the CDCM as a HV connected customer, the distributor will be making a charge in respect of EHV (and possibly HV) assets which he does not own and for which he does not incur costs.

¹ In this context operating means operation, maintenance, costs of reinforcement not recovered as a capital contribution from other consumers, and the replacement of assets

Even though the customer is metered at HV the customer has responsibility for the operation and replacement of those assets under his control and ownership (and liability for the costs associated with such activity).

We agree that it is economic, efficient and pragmatic to meter such connections at HV but charge them, correctly, as EHV sites. LLFCs in respect of such sites can take into account apply the relevant adjustments to refer the electricity consumed back to the EHV level. (A separate mechanism may be required

Question 4: We welcome views on how customers subject to 'special' settlement arrangements should be treated in the definition of the boundary.

See our response to question 3.

Settlement arrangements do not define the costs of operating the distribution network. Our view is that the methodology should be defined by the ownership boundary. We recognise that metering at HV may need to be "adjusted" to take additional losses into account; however, the voltage of metering should not define the ownership or connection boundary.

Question 5: We welcome views on how 20kV customers should be treated in the definition of the boundary.

Customer connected at 20kV are, by definition, HV customers. Therefore, they should be subject to the CDCM and generic HV tariffs. There may be a case for developing different generic tariffs for customers connected at 20kV as opposed to 11kV. Such a modification could be proposed under the CDCM open governance arrangements.

Chapter 3 Questions

Question 1: What are your views on our suggested factors for considering the boundary options, and are any other factors relevant?

We note Ofgem's comment that CDCM and EDCM may lead to perverse incentives to connect at a connection level purely based on the differential in charges.

However we note Ofgem's open letter of 4 May 2005, suggested that such perverse incentive already exist within the CDCM, and not just between the EDCM and CDCM. The letter also made reference to DNO obligations under section 9 of the Act. We are concerned that the CDCM and the EDCM may distort competition because they are not cost reflective.

We agree that there is [significant] scope to improve the cost reflectivity of the CDCM and EDCM (paragraph 3.6).

We note Ofgem's concerns over the risk of undue discrimination. We believe such concerns are valid. It is for this reason that we believe that the charging methodology should be common to all uses of a given type.

Question 2: What are your views on the grounds and issues that should be taken into account in determining whether any potential discrimination can be objectively justified? What are your views as to whether discrimination occurs in respect of the options under consideration?

We believe that in exceptional circumstances there may be some grounds for alternative treatment without being unduly discriminatory. For example, this may be where a connection is provided at a higher voltage than it would normally provide to accommodate the customer's maximum power requirement in order to accommodate disturbing (reactive) load.

We believe that there is potential for undue discrimination in all the options apart from option 2 (option RB).

Question 3: We seek views on option 6 along with views on any of the hybrid approaches that respondents consider appropriate.

Option 2 (option RB) could be modified to make the charging boundary at the outgoing terminals of the EHV/HV substation. We understand that DNOs have relevant information to facilitate such a boundary.

Question 4: We seek views on the role/treatment of 'sole use' assets in defining the CDCM/EDCM charging boundary and on metering and settlement issues that have been raised.

See our response to earlier questions. We are not sure that sole use assets have a role in defining the connection boundary. We believe that, by and large, the connection boundary is defined by the voltage of the ownership boundary. All customers, to a greater or lesser extent will have sole use assets (e.g. at LV domestic customers will have a service line, a remote customer may have a HV service line, pole equipment and service line as a sole use asset).

Question 5: What issues are there around charging impacts? In relation to these are any specific measures required?

Charging impacts are as much about the methodology as they are about the boundary. We have significant concerns about the methodologies employed in the CDCM and the EDCM.

Our primary concern is that reinforcement models and scaling factors may distort the allocation of allowed revenue. As a consequence charges may not be reflective of the true costs of operating the business.

Question 6: In view of this chapter and the impact assessment in Appendix 3, what is your preferred option for the boundary, and why?

Our preferred option is option 2. However as described in our responses to question 1 in chapter 2, and question 4 in chapter 3 we recognise that connection boundary at the outgoing HV terminals of an EHV/HV substation could also be considered. This would address some of the concerns identified by Ofgem.

Chapter 4 Questions

Question 1: We seek views on the next steps we have noted and the associated timescales.

No comment.

Question 2: We seek views on whether the boundary should additionally change over time, for example in response to technological developments.

We recognise that there is potential for significant change in the not too distant future with the advent of smart grids and smart metering and potential changes to commercial arrangements with consumers (e.g. demand side management). Clearly this could significantly influence the boundary at which sites should be charged on site specific tariffs.

However, it should not be lost on Ofgem that customers require predictability and certainty of charges going forward. Developing boundaries and methodologies that introduce volatility does not protect the interest of consumers.

Any change in the boundary may result in the perverse allocation of costs, for example, customers being required to pay DUoS in respect of assets that the distributor does not own (as would be the case if the charging boundary was the metering boundary rather than the ownership boundary) leads to what is in effect double charging. We note that issues arising from changing the DUoS boundary for generators in 2005 are still to be resolved.

Therefore, in changing boundaries it will be necessary to identify how the cost allocations change and whether any compensation arrangements are required.