SP ENERGY NETWORKS

Regulation & Commercial

Your ref

Our Ref

Date
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Contact / Extension
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Dear Nicholas,

Charges for pre-2005 Distributed Generators' use of DNOs' distribution systems

I am responding on behalf of SP Distribution Limited (SPD) and SP Manweb PLC (SPM), the licensed distribution businesses serving the South of Scotland, Merseyside and North Wales, to the second part of the above recent Ofgem consultation.

Our responses to the questions posed in the consultation are as follows:

Existing pre-2005 DG contracts

Our review of pre-2005 DG contracts (in relation to use of system rights granted by SPD/SPM within Connection Agreements) has identified that these fall within the following broad categories:

SPD	Rights to Use of System?	Basis of Use of System Rights
Category 1	No	None. Right to be connected only.
Category 2	Yes	Rights subject to terms and conditions, specifically CVA registration. Where use of system provided customer has obligation to pay use of system charges.
Category 3	No	No site specific terms in place. The fall back position is the National Terms of Connection.

SPM	Rights to Use of System?	Basis of Use of System Rights
Category 1	No	None. Right to be connected only.
Category 2	Yes	Rights subject to terms and conditions, specifically CVA

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		registration. Where use of system provided customer has obligation to pay use of system charges.
Category 3	No	No site specific terms in place. The fall back position is the National Terms of Connection.
Category 4	Yes	Rights subject to terms and conditions. Contract states that use of System Charges for export will be notified to the Generator.
Category 5	Yes	Subject to terms and conditions. Use of System Charges for import only addressed. No explicit reference to export charges.

For SPD, prior to 2005, rights to use of system were explicitly excluded from Connection Agreement terms (Category 1). Post April 2005, SPD introduced Connection & Use of System Agreements (Category 2). Whilst rights to use of system were conveyed in these post 2005 Agreements, they were restricted to DG choosing to trade the electricity generated in CVA, either independently or via a consolidator. Charges for Use of System were applied in such circumstances. The rights of DG choosing to trade though a Supplier in SVA were restricted to the right of connection and being energised. These rights were subject to the terms of the Agreement and included the requirement for there being a contract(s) in place between the DG party and a Supplier for the (i) supply of electricity; and (ii) the purchase of any electricity generated, and that Supplier(s) having in place an agreement with SPD for Use of System. There are no examples of pre 2005 CVA DG in the SPD area.

The range of contractual arrangements in place in the SPM area is more varied. Even so, the significant majority of generator connections fall into the same Category 1 and 2 bandings prevalent in the SPD area. The majority of pre 2005 DG is SVA registered.

There are some examples in both the SPD and SPM areas of pre 2005 DG without Connection Agreements or for which we have been unable to find signed documentation (Category 3). In such circumstances we consider that the National Terms of Connection (NTC) should be applied until such times as site specific arrangements are agreed between the parties. The NTC terms convey no rights to use of system.

Those pre 2005 DG falling into the Category 4 and 5 bandings were predominantly contracted during the period 1990 to 2000 and were classified, at that time, as being "Pooled" or "Non Pooled Generation". Whilst a common rule regarding use of system rights is not immediately apparent from these Agreements, there are a small number of pre 2005 DG for which use of system rights were provided without there being a corresponding entitlement for SPM to charge use of system export charges.

There are no fixed term Agreements with pre 2005 DG in the SPD area and only a small number in the SPM area.

Principles for assessing the efficiency of any compensation paid

Q1: Criteria to be applied to determine when it is appropriate to pay compensation.

We do not consider it appropriate for compensation to be paid in the following circumstances:

A) In respect of use of system charges:
- We consider that the rights for pre 2005 DG to receive compensation in respect of future use of system charges has yet to be established.

B) In respect of operation and maintenance (O&M) charges:
- Where O&M charges are currently paid on an annual basis.

C) In respect of reinforcement charges:
- Where pre 2005 DG have, in respect of their connection, paid charges only associated with network extension assets, i.e. no contribution has been received for reinforcement works required to facilitate the DG's connection.

We consider it may be appropriate for compensation to be paid in the following circumstances:

A) In respect of use of system charges:
- We consider that the rights for pre 2005 DG to receive compensation in respect of future use of system charges has yet to be established.

B) In respect of operation and maintenance (O&M) charges:
- Where O&M charges have been paid on a capitalised basis and the time period covered by those charges has yet to expire.

C) In respect of reinforcement charges:
- Where contributions to deeper system reinforcements have been made, only in circumstances where those assets would be funded by the DNO through the DG incentive mechanism (if the connection progressed under current arrangements).

Q2: Method(s) used to calculate compensation.

A) Use of system charges – Should the legal right to receive compensation for future use of system charges be clearly established, we consider that compensation payments made by DNOs should be on the basis of a fully transparent and nationally agreed compensation scheme established by Ofgem.

   We do not consider it appropriate that decisions regarding the appropriate levels of compensation to be paid should be agreed on a bilateral basis. Any compensation payments made by the DNO should be calculated using a nationally agreed process and fully backed-off with an appropriate regulatory funding mechanism.

B) O&M charges – We consider it appropriate that compensation of upfront (capitalised) payments should be made based on the remaining unexpired value.

C) Reinforcement charges – Where customers consider that payments have been made in respect of deeper system reinforcements (and those payments would not currently be

required to be customer funded under current charging arrangements), those customer should be given the opportunity to present a case for refund to the DNO. Any compensation payments made by the DNO as a result, should be fully backed-off with appropriate regulatory funding.

Q3: Compensation payments in cases where contracts allow for variations in charging arrangements

Many of the Connection Agreements held by SPD and SPM contain provision that charges in respect of use of system will be calculated in accordance with "...the Company's Statement of Use of System Charges for the time being in force..." or be "... notified to the Generator by the Company".

We do not consider it appropriate that refunds be provided in instances where agreement has been made based on a recognition of the requirement (whether current or future) to pay such charges.

Q4: Rights to compensation based on the value of expected use of system charges

We consider that the rights for pre 2005 DG to receive compensation in respect of future use of system charges has yet to be clearly established. Furthermore, the basis on which the value of compensation paid could be established is uncertain at best. Difficulties include:

- Regulatory policy in previous price controls
- Volatility in charging arrangements
- Period over which compensation would be paid
- Arrangements for subsequent refunds from customers, i.e. potential early termination of connections

We consider that any compensation payments made by DNOs should be on the basis of a fully transparent and nationally agreed compensation scheme established by Ofgem.

Q5: Appropriateness of principles applied to HV/LV to EHV customers

We do not believe the historic contractual arrangements of these customer segments would lead to compensation being necessary. However, this is clearly open to customer challenge and should it be established that compensation is appropriate then the arrangements applied in respect of EHV customers would also be appropriate for HV/LV customers.

Q6: Other proposals or relevant issues not identified in this consultation

As stated in our previous response (dated 20th August 2010):

Bundled approach for O&M charges
We believe that contributions to capitalised O&M should be considered separately from other connections charges (which tend to be customer contributions covering the capital costs of installed assets).

We see merit in a bundled approach for O&M charges and unbundled approach being adopted for other charges. Our main thoughts for applying a different approach between these charges are as follows;

a) These O&M charges are a contribution to future costs, cover a defined period and relate directly to a specific element of cost that is also distinct within the ECDM model (both based on the value of sole use assets) and therefore it can easily and transparently be included or not.

b) This will be a transitional difference and pre 2005 generators should attract this component of the EDCM charge once their capitalised O&M period has expired.

c) A bundled approach to O&M would not affect the locational element of the charges. It is unclear to us how the locational price signal would be diluted by bundling this component.

Funding of compensation

It is not clear that the logging up mechanism in the DPCR5 final proposals intended to deal with compensation of O&M, or other compensation to generators, but rather is targeted specifically at compensation of capital contributions to assets. For example, quoting from the relevant sections in the DPCR5 final proposals, Incentives and Obligations, Section 4.9 (I have highlighted in bold one example of the wording which leads us to our conclusion).

> "At DPCR6 we will undertake an efficiency assessment in order to calculate the compensation allowance. We will then provide funding for this allowance through:
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> - an adjustment to their regulatory asset value (RAV) to reflect the remaining life of the assets, and
> - revenues to compensate for depreciation and return accrued over DPCR5 and the cost of the delay in their payment."

The scale of refunds resulting from capital contributions to assets is likely to be a small proportion of the probable refunds arising from capitalised O&M. Including capitalised O&M and other compensation into the logging up mechanism, which appears was originally intended for lower (in terms of overall materiality) refunds of contributions to assets, creates a new cost for DNOs during DPCR5 that may not have been considered at the time of the DPCR5 final proposals. Consequently it may be more appropriate for such compensation to be dealt with through a reopener mechanism if an unbundled approach is adopted.

A fully unbundled approach (including O&M) is likely to impact some DNOs disproportionately, particularly affecting those companies who have delivered significant volumes of renewable generator connections during DPCR4 and during DPCR5 (where these were contracted on DPCR4 terms).

EHV demand customers

We remain concerned that refunds to EHV demand customers who have also paid capitalised O&M have not been considered either by consultation or by any regulatory mechanisms. Whilst these are small in volume and have a relatively smaller capitalised O&M payment than the pre 2005 DG portfolio, the unbundled proposals appear to discriminate against these customers. This can easily be resolved by allowing the O&M element of the EDCM charges to be bundled for both demand and generation customers and by setting the MEAV driving the O&M component of these customers EDCM charges to £0 for the appropriate period.

Q7: Evidence of potential magnitude of compensation

The scale of compensation is likely to be dominated by use of system, should it be established it is appropriate for pre 2005 DG to be compensated on this basis. The scale of refunds resulting from capital contributions to assets is likely to be a small proportion of the probable refunds arising from capitalised O&M. Including capitalised O&M and other compensation into the logging up mechanism, which appears was originally intended for lower (in terms of overall materiality) refunds of contributions to assets, creates a new cost for DNOs during DPCR5 that may not have been considered at the time of the DPCR5 final proposals. Consequently it may be more appropriate for such compensation to be dealt with through a reopener mechanism if an unbundled approach is adopted.

Q8: Special contracts and compensation through the price control

The contractual relationship which SPD and SPM have with their respective pre 2005 DG customers are reflective of what were the normal and accepted arrangements at that time. Our contract review has not identified "special contracts/rights" at this time.

Q9: Other views / comments

We have no other comments to make at this time.

Yours sincerely,

by email

Jim McOmish
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