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| Modification proposal: | <b>EDF Energy Networks<sup>1</sup> (EDF) proposal to amend its Use of System (UoS) charging methodology for excess reactive charging to designated EHV properties.</b> |                      |     |
| Decision:              | The Authority <sup>2</sup> directs that this proposal is vetoed <sup>3</sup>   |                      |     |
| Target audience:       | DNOs, IDNOs, Suppliers, Generators and other interested parties  |                      |     |
| Date of publication:   | 4 November 2010  | Implementation Date: | N/A |
|                        |  | 1 December 2010      |     |

## Background

Distribution Network Operators (DNOs) have obligations under the Electricity Distribution Licence (the "Licence")<sup>4</sup> 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.

On 1 April 2010, the Common Distribution Charging Methodology (CDCM) was introduced and replaced DNOs' existing HV/LV UoS charging methodologies. The CDCM is a common UoS charging methodology that was developed by all DNOs and approved, subject to conditions, by Ofgem on 20 November 2009<sup>5</sup>. Consequently, DNOs' individual statement of UoS charging methodologies currently only relate to the calculation of UoS charges for customers connected to DNOs' extra-high voltage (EHV) networks.

In addition to the CDCM, DNOs are also obliged in accordance with SLC 50A to develop common charging arrangements in relation to customers connected to their EHV networks. It is expected that they will have in place an EHV Distribution Charging Methodology (EDCM)<sup>6</sup> from 1 April 2012. The EDCM will replace DNOs' existing EHV UoS charging methodologies.

EDF has decided to amend its methodologies in relation to how they charge for reactive power.

Although reactive power does not utilise actual energy, on a large scale it can lead to a reduction in the overall efficiency of the network, for instance, the network operator may need to increase the size of network assets, and it needs to be actively managed by the network operator.

Power factors (*pf*) are a measure of the efficiency of the system. The power factor ratio will be 1 (one) where current and voltage are perfectly phased, reducing to the extent that the current (amps) lags behind the voltage. A charge may be levied where the overall *pf* falls below 0.95.

<sup>1</sup> EDF Energy Networks is now called UK Power Networks in respect of Eastern Power Networks PLC, London Power Networks PLC and South Eastern Energy Networks PLC. This letter applies to all three licensees.

<sup>2</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>3</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>4</sup> Standard Licence Condition (SLC) 13.

<sup>5</sup> 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).

<sup>6</sup> This work is set out on the Energy Network Association's website at: <http://2009.energynetworks.org/edcm/>.

For further information see our July 2009 decision letter at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=487&refer=Networks/ElecDist/Policy/DistChrgs>.

This modification concerns EDF's charges for excess reactive power. EDF levies a charge where the number of reactive units consumed exceeds a pre-determined percentage of KWh. EDF considers that this charge provides a behavioural pricing signal to customers to improve their power factor. This can be done by investing in *pf* correction equipment which will reduce the amount of reactive power.

From 1 October 2010 EDF updated its Statement of UoS charges to apply the same charge across its two charging bands for excess reactive power, effectively merging them. EDF argued that this change was introduced to provide consistency between CDCM and EHV charges where appropriate and to avoid confusion to customers and suppliers. Since the change did not constitute a change in form of the statement of UoS charges the Authority was not able to consider this change in its decision to approve the form of the statement on 29 September 2010.

The Authority considered this change to EDF's charges to be a change to its charging methodology. In response EDF submitted a modification proposal detailing the changes to be made to its statement of UoS charging methodology.

### **Summary of EDF's proposals**

On 6 October 2010 EDF submitted a modification report (EDF UoS 34) that it believes sets out its proposals to modify its statement of UoS charging methodology. In particular, EDF has proposed to amend its Statement of UoS charging methodology to align the application of excess reactive charging to designated EHV properties on to the same charge application basis as the CDCM. EDF has stated that the change proposal changes the excess reactive charge application from three charging bands to two charging bands.

EDF's modification report states that "the change does not involve any change to the EDF charging methodology statement". The current wording states "The excess reactive power charge, applied in bands according to the level, provides a behavioural pricing signal to customers to improve their power factor". The text of the methodology stops short of naming the number of bands. The modification report goes on to detail the changes previously made to EDF's statement of UoS charges <sup>7</sup>.

It is the Authority's view that while EDF has submitted a modification proposal it has not sought to modify EDF's statement of UoS charging methodology in that no changes have been made to the text of the statement of UoS charging methodology. It is the Authority's view that EDF's statement of UoS charging methodology needs further clarity.

EDF states that the change is being proposed to assist the industry by providing the same excess reactive charge application that is used for HV and LV tariffs to EHV tariffs for designated EHV properties. However, we note that following a discussion with EDF a primary driver for changes to its EHV charging methodology is that their billing system currently bills customers in this manner. The change to their billing system for LV and HV was necessary to ensure that EDF complied fully with the CDCM when it came into force on 1 April 2010.

EDF have stated that their proposal has a very small impact on charges and that it will impact one designated EHV property in the LPN area, four designated EHV properties in the EPN area and none in the SPN area. EDF has calculated that the effect of the change

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<sup>7</sup> Full details of EDF's proposals can be found in its modification report which is published on our website at: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=757&refer=Networks/ElecDist/Policy/DistChrgMds>.

will be an average reduction in reactive charges for these five sites of £75 a month against average monthly distribution charges of £18,600 per month.

### **Reasons for the Authority's decision**

In coming to its decision **to veto** this proposal, the Authority has considered the proposed modification against the Relevant Objectives<sup>8</sup> and the Authority's principal Objective and wider statutory duties<sup>9</sup>. Given that no change to the actual text of the methodology has been proposed by EDF, the Authority has considered the change in methodology inferred by the changes made to EDF's statement of UoS charges against the Relevant Objectives.

In summary, we have vetoed EDF's proposal because we consider that it has not presented a compelling case for change against the Relevant Objectives. In particular, we consider that the arguments made are weak and unproven.

The following paragraphs set out our rationale against the Relevant Objectives in more detail.

*Relevant Objective (a) – that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act<sup>10</sup> and by this licence;*

EDF has not sought to justify this modification against Relevant Objective (a) and therefore the Authority has not been provided with any evidence that the proposed change better facilitates the discharge of the obligations imposed on EDF under the Act and the Licence. The Authority does not consider that the change proposed in this modification better achieves Relevant Objective (a) as neither the Licence nor the Act specify how customers should be charged for excess reactive power.

*Relevant Objective (b) – 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;*

EDF states that the introduction of this proposal would align EDF's designated EHV properties excess reactive charge application to the same excess reactive charge application as all other DNOs. They consider that this increased consistency would help suppliers to pass on the charges accurately to their customers on a 'level playing field' basis and therefore not advantage or disadvantage any suppliers enhancing competition in the supply of electricity.

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<sup>8</sup> The Relevant Objectives for the use of system charging methodologies, as contained in paragraph 3 of SLC 13 of the distribution license respectively are:

- a. 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;
- b. 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;
- c. 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
- d. 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.

<sup>9</sup> The Authority's statutory duties are detailed mainly in the Electricity Act 1989, Gas Act 1986, Utilities Act 2000, Competition Act 1998, Enterprise Act 2002 and the Energy Act 2004 as well as arising from directly effective E.C. legislation.

<sup>10</sup> Electricity Act 1989.

We consider that EDF's intention to provide consistency to suppliers may be an appropriate way of improving their charging methodology. The Authority agrees that common charging across DNO methodologies can promote competition in supply. However, since this modification affects only one charging structure in EDF's methodology, leaving other charges uncommon across DNOs, the Authority does not consider the change proposed in this modification to be material enough to, in itself, improve competition in supply.

*Relevant Objective (c) – that compliance with the 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;*

EDF has not sought to justify this modification against Relevant Objective (c) and has not set out how its proposed approach would be any more cost reflective. The Authority considers that since EDF is reducing the number of charging bands for excess reactive power it is possible that it will reduce cost reflectivity. Therefore, the Authority does not consider that EDF's proposal results in charges which better reflect the costs incurred by EDF.

We are mindful that there is an argument for proportionality against vetoing this modification as the proposed change affects few customers and has a negligible effect on actual charges. For instance, we recognise that a reduction in the number of bands may increase clarity of the charging regime for customers and potentially facilitate administrative efficiencies. However, we have been provided with no evidence on the likelihood or scale of these improvements and are therefore unable to conclude that they would outweigh the charges becoming less cost reflective, however marginally. We consider that it is inappropriate to allow a modification that is not proven to better achieve the Relevant Objectives set out in paragraph 3 of SLC 13 of the distribution licence.

*Relevant Objective (d) – that, as far as is consistent with the sub-paragraphs (a), (b) and (c), the use of system charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's distribution business;*

EDF states that the change reflects the application of charges as part of the introduction of the CDCM and therefore takes account of developments in the licensee's distribution business.

Whilst the CDCM did introduce a common method of charging for excess reactive power for LV and HV, it was not intended that it would necessarily influence EHV charging, therefore we consider that EDF's proposal may have been avoided had a change to their billing system been limited to HV and LV charging. Further, DNOs have had their obligation to review their charging methodologies on an annual basis relaxed (see SLC 50A.5) and the Authority does not consider that EDF should seek to predict the outcome of the CDCM by changing its charging methodology at this point in time. The Authority notes that EDF may have considered it more cost reflective to make the change to its billing system to affect EHV as well as LV and HV customers, rather than running a separate process for EHV customers. However, EDF has not sought to argue this point against the Relevant Objectives nor has it provided the Authority with any evidence that it is the case.

Since the Authority does not consider that EDF has presented a compelling case against any of Relevant Objectives (a), (b) and (c), we cannot conclude that EDF's proposals will better achieve Relevant Objective (d). In particular, we would be concerned that in accepting a modification that did not meet any of Relevant Objectives (a), (b) or (c) and that allowed the methodology to remain vague (in that it does not specify the number of

charging bands) it would allow EDF to make, what would otherwise be a methodology change without the approval of the Authority, by simply making changes to the charging statement. The lack of clarity in the methodology needs to be addressed by EDF.

The Authority also notes that if EDF had sought to name the number of bands to be applied in its statement of UoS charging methodology, this could be viewed as EDF better achieving the discharge of its obligations under the licence, namely Relevant Objective (a). The Authority considers that naming the number of bands could result in the statement of UoS charging methodology being a more complete and documented explanation of the methods, principles and assumptions that apply to EDFs charges.

If you have any questions relating to the issues discussed in this letter please contact Rebecca Langford, either at [Rebecca.Langford@ofgem.gov.uk](mailto:Rebecca.Langford@ofgem.gov.uk) or on 020 7901 7388.

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', is positioned above the typed name and title.

Rachel Fletcher  
**Partner, Distribution**  
**Signed on behalf of the Authority and authorised for that purpose**