

Ynon Gablinger
Ofgem
9 Millbank
London
SW1P 3GE

Reference Number: 67/11
Email: distributionpolicy@ofgem.gov.uk
Date: 4th July 2011.

Electricity distribution charging methodologies: DNOs' proposals for the higher voltages

Ynon,

SmartestEnergy welcomes the opportunity to respond to Ofgem's consultation on Electricity distribution charging methodologies: DNOs' proposals for the higher voltages.

We note that views are sought on some specific issues. We address these issues below. The remainder of this response answers the questions in the order in which they appear in the document:

Demand – calculation of capacity for allocation of costs and the residual (Issue 3) – this calculation uses two different units of capacity (kVA and kW). We seek views on whether using different units is appropriate, as it affects how much reactive power is taken into account.

We do not have particularly strong views on whether two units are used. However, we feel that there should be consistency with CDCM. It would seem sensible to be consistent with all units across the measures of capacity, including reactive and active. That said, the final decision to include/exclude may be driven by principles or scientific reason and these should be articulated in the decision.

Demand – customer categories (Issue 7) – the methodology includes 15 different categories of customers but these may not be necessary for the operation of the charging model. Removing these categories may reduce complexity and increase transparency, so we seek stakeholders' views on whether they are actually required.

We do not consider this to be a major issue. We are comfortable with the DNOs' approach

Demand - sole use asset charge (Issue 17) – for the majority of revenue recovered by scaling, only the customer’s shared assets are taken into account in determining their share of revenue. We invite stakeholders to respond on whether they are comfortable with this, or think sole use assets should also be a factor.

We are comfortable with only the customer’s shared assets being taken into account in determining their share of revenue. Revenue scaling does not need to be applied to sole use assets.

Generation - charges for mixed sites (Issue 12) – the methodology applies a fixed assumption about the amount of assets used by the demand side of site that also has generation. We seek stakeholders’ views on whether this assumption is appropriate, given the difficulty of estimating a reasonable value.

We believe that determining whether a site is demand or generation dominated purely on capacities could lead to some anomalies. An assessment should be made on specific site circumstances i.e. on a site-by-site basis.

Common - demand and generation side management agreements (Issue 18) – these agreements offer the possibility for customers to reduce their charge, so we are keen to understand from the DNOs whether any customer can enter such agreements or whether they are at the discretion of the DNO.

We would be keen to understand this, too! We can understand that there may be reasons why DNOs would like some discretion here but their reasons would need to be justified. We feel that what is required is some rules/parameters i.e. known circumstances where DNOs would not allow a customer to enter into an agreement.

LDNOs – capping of discounts on charges (Issue 16) – currently discounts for LDNOs may be no higher than 100 per cent of the charge. While there are no instances of discounts greater than this, we encourage stakeholders to respond on whether this cap is appropriate, particularly if stakeholders feel it may be an issue in the future.

A cap is not appropriate as we can foresee circumstances in which a net payment may be correct i.e. where there is net generation in a high demand area.

Please find below our answers to the numbered questions as they are laid out in the Consultation document.

Question 2.1: What are your views on the key issues with the methodology we have highlighted? Are there any other issues or concerns with the methodology as a whole that we should consider?

We agree that distribution network users should be encouraged to make the most efficient use of the existing infrastructure and to contain the amount of new investment that customers have to pay for. This has nothing to do with the transition to a low carbon infrastructure per se. It is economic sense.

We are fully supportive of initiatives which ensure that rewards are available for network users who manage their demand patterns to avoid using the network at peak times or who provide other benefits, such as generators who offset local peak demand.

We agree also that the proposals submitted by the DNOs represent a substantial improvement on the DNOs' current methodologies and that the methodology largely meets the objectives set out for the project. The desire for commonality is to be commended.

We believe that there may be a case for intermittent generators, such as wind farms, to receive credits and that the DNOs should undertake further work to ensure the cost of spare capacity in assets is appropriately allocated to customers.

We agree that charges should reflect the costs (or benefits) imposed by users on the network. However, there should be some mitigation through appropriate averaging and smearing.

To that end we agree that where there is spare capacity on assets that is not used by anyone, it is appropriate to recover the associated costs across all users, through the scaling process

Question 2.2: Should we approve the methodology, do you agree with our proposal to implement it in full from 1 April 2012? If not, why is phasing-in charges or delaying implementation appropriate?

We have previously argued in favour of phasing. However, if it is true that the vast majority of outliers have been removed by capping the network usage factors then this may not be justified for the number of customers affected.

Further capping at this level should be considered as a means of phasing.

Phasing in or capping is appropriate (if there were more than a handful affected) because it is likely that some suppliers may have signed long term

agreements with customers on fixed rates without knowing the outcome of the EDCM process.

But we are supportive of introducing the methodology as soon as possible as the models give the best indication yet of what future charges might be.

Question 3.1: Do you agree with our assessment that the approach for the revenue target is reasonable?

Yes

Question 3.2: Do you think the principle the maximum import capacity is a cost driver at the voltage of connection is reasonable for charging purposes?

We can accept this as a starting point. However, in the future we feel this may be an area for greater sophistication in the future.

Question 3.3: Do you agree with our view that reactive power flows should be incorporated as part of the capacity that attracts indirect costs and 20 per cent of the residual?

We agree that peak time capacity *should* incorporate reactive power flows in order to account for the full cost implication of the customer's active power consumption during system peak. This is on the basis that the proportion of the network capacity the customer uses includes active and reactive.

We would question whether it is appropriate that customers should be charged reactive on the basis of historic use as a forwards estimate, i.e. that there is no explicit metered reactive charging in the charging year. The issue with using estimates is that there is a time delay across charging periods - customers consuming consistently less reactive will always be paying too much and vice versa.

We can see that the DNOs' direct operating costs and network rates are considered to be closely linked to network assets, and therefore best allocated using assets (shared and sole use) as the driver. We do not, however, follow the logic that indirect costs are more appropriately allocated according to customer size; there is just less of a link to network assets.

Question 3.4: Is it appropriate to consider the specific assets the customer uses for the calculation of the customer's charge, or would it be more appropriate to consider only the voltage levels the customer uses for the calculation of its charges?

Only the voltage level the customer uses should be considered at this time.

The voltage level approach should be considered primarily on the basis that customers' charges are and will be driven by the historic and future organic evolution of the network. It is unlikely that assets at other voltage levels would historically be, or continue to be, sole use.

A secondary reason for voltage level charging is that the site specific approach has a number of broad assumptions which go into the NAR and it is not yet a cost reflective charging solution. On this basis the voltage level approach should be adopted until such time as the networks have conducted the relevant costing to show that the NAV does not contain estimates and therefore can be said to be cost reflective.

Question 3.5: Do you think that the 'spare capacity' issue we identify should be addressed?

Yes. We approve of Ofgem making it a condition of their approval of the EDCM that DNOs investigate the implication of the issue raised, its materiality and whether the current cap in place is an effective measure.

Where there is spare capacity on assets that is not used by anyone, it is appropriate to recover the associated costs across all users, through the scaling process.

Question 3.6: Do you think notional asset values should take into account assets below the customer's voltage of connection?

No

Question 3.7: Are there any other demand specific issues that you think we should consider as part of our decision?

Our preference is for voltage level scaling for three reasons; 1) voltage level scaling is consistent with the CDCM 2) voltage level scaling is the charging structure which best reflects the historic incremental development of the networks and 3) voltage level scaling will result in less volatile changes as new customers join the network.

From our perspective there is no getting away from the fact that site specific charging is not appropriate due to the fact that the system configuration is a result of investment decisions which have been made over a long period of time i.e. it cannot change dynamically and the system would look very different if it were to be rebuilt completely and efficiently at any snapshot of time.

This is a key issue and, given the level of detail of other issues, we are surprised that Ofgem has not consulted on this.

Question 4.1: Do you agree with our proposal to modify the generation revenue target in order to avoid double charging for operations and maintenance costs on sole use assets? This issue aside, do you agree with our view that the approach to calculating a generation revenue target is reasonable?

Yes and yes

Question 4.2: Do you agree with our assessment that the approach to scaling is reasonable?

We understand the principle that scaling by capacity makes more sense for demand and by asset value for generation. However, this takes no account of actual circumstances and the old 80/20 rule seems rather arbitrary, too. We feel that the methodology should be a little more scientific. At the very least rules should be developed for where this generic methodology is inappropriate. We feel that it should be on a network specific basis approved by Ofgem.

Question 4.3: Do you think it is appropriate for only units exported by non-intermittent generators during the super-red time band to be eligible for credits?

We believe that generation credits should be issued for generation delivered at times of system peak, regardless of the generation technology as we feel it is important to reward intermittent generation where it helps the system. Thermal generation will be able to more reliably respond to this price signal than intermittent generation and so is likely to receive more credits in relation to its capacity.

There should be no discrimination; generation credits should be issued in the 'red' time periods and issued for all types of generation, rewarding generation at times of system peak. The method should also reward a demand side response from sites during the identified times of system stress. 'Red' band peak credits are a key success of the CDCM which there is now an opportunity to repeat in EDCM.

Intermittent can only be excluded on the basis that it was not designed to offset reinforcement can only be justified if the reward is made on a capacity basis. As it is, the proposal is on energy.

Question 4.4: Do you agree with our proposal that intermittent DG should be eligible for credits as they are deemed to provide network benefits under ER P2/6? If they do become eligible for credits, should the credits only relate to units exported during the super-red time band or is a single credit rate to all units exported more appropriate?

First and foremost the arrangements should be the same regardless of the generation type. We believe that generation credits should be issued for generation delivered at times of system peak i.e. red periods as the purpose is to reward generation produced at times of stress.

The bottom line is that the existence of intermittent capacity does reduce the amount of capacity investment customers would otherwise have to pay for.

Question 4.5: On import charges for generation dominated mixed import-export:

Do you agree with our suggested alternative to using the collar of the network use factor for the calculation of the import tariff?

Yes

Do you think that the methodology is appropriate for demand customers connected to generation dominated assets?

Yes

Question 4.6: Are there any other generation specific issues that you think we should consider as part of our decision?

No

Question 5.1: Do you agree when calculating LDNO charges that DNO costs upstream and downstream of the point of connection should be considered?

No. There needs to be a clear boundary, just as there is between the DNOs and NGT.

We are surprised that Ofgem is not seeking views on Issue 13. The document states: "It will not always be possible for an LDNO to identify the point of connection by the metering point, as there will not always be a meter in place to measure flows between the DNO and the LDNO." This is not a tenable excuse. LDNOs must be able to identify the voltage at which their customers are connected.

Question 5.2: Do you think that DNOs should provide LDNOs with a discount on all non-asset based charges?

We have no view on this

Question 5.3: Do you think that varying LDNO discounts only with the point of connection will better achieve a balance between reflecting upstream and downstream costs?

Yes

Question 5.4: Do you agree that it may be appropriate in some circumstances for the DNO to pay LDNOs use of system credits?

Potentially for net exporting LDNOs at times of system peak.

Question 6.1: Do you think sole use assets should attract scaling 'costs' to the same extent as shared assets? Does the charging rate on sole use assets seem reasonable given the nature of these assets?

We can understand why Ofgem are challenging this as it appears inconsistent. However, applying scaling costs to sole use assets will create greater volatility in tariffs. In the interests of dampening some of the more extreme outcomes we feel Ofgem should not pursue this.

Question 6.2: Do you agree with our view that the arrangements for demand and generation side management agreements are appropriate? Do you think such agreements should be available to all customers?

We do not believe that the arrangements for demand and generation side management agreements are appropriate whilst there are no arrangements in place for compensation.

We do think that such agreements should be made to all customers.

Question 6.3: Do you agree with our assessment that an explicit reactive power charge is not appropriate?

Yes. We have previously stated that the method proposed by the DNOs for applying reactive charges is appropriate insofar as it is consistent with the CDCM but that this should be reviewed.

Question 6.4: On the proposal for sense checking branch incremental costs in LRIC:

Do you agree with our view that positive cost recovery (ie charges) and negative cost recovery (ie credits) should be considered separately?

We agree charges and credits should be considered separately as fundamentally demand and customers should not pay more than the asset would cost to reinforce, the power flows assumptions for in both instances being opposite.

Do you consider that recovery from demand customers and recovery from generation customers should be considered separately?

No. When considering revenue recovered in respect of an asset reinforcement it should be the cumulative recovered from demand and generation customers as both demand and generation will benefit from the increased in network capacity brought about by the reinforcement.

The increased capping in both instances serves to prevent customers being overcharged by the model for reinforcement of an asset.

Question 6.5: Do you think the EDCM should include a mechanism to mitigate the potential volatility from network use factors? We welcome views on measures to mitigate volatility and help customers manage volatility.

Yes. Controlling network use factors is a simpler way of reducing outliers than capping or phasing out-turn tariffs.

Should you wish to discuss any aspect of this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich
Deputy VP Commercial – Head of Regulation
SmartestEnergy Limited.

T: 020 7195 1007
M: 07764 949374