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Response to consultation: Charges for pre-2005 distributed generators' use of DNOs' distribution systems − proposed guidance − 58/11

Dear Andrew

Thank you for the opportunity to comment on the above consultation. I am responding on behalf of our four licensed distribution companies: Eastern Power Networks plc, London Power Networks plc, South Eastern Power Networks plc, and UK Power Networks (IDNO) Ltd.

Our detailed response is contained in the attached appendix; however, we would like to draw Ofgem's attention to the following points:

- While we are comfortable with Ofgem's proposed increase in scope, to include HV and LV as well as EHV generators, we wish to ensure that Ofgem is aware of the considerable increase in the volume of generators and the work this now entails. In our case, we are now looking at up to approximately 350 generators. With the increase in work that entails, coupled with the limited engagement to date from suppliers, we are concerned that the target date for completing refunds of 1 April 2012 may no longer be workable – although we are now considering undertaking an assessment as to what an achievable date is.
- Due to the limited availability of paperwork for most of the generators, we are proposing a modelling approach to calculating the refunds. For this to work, we seek Ofgem's support of the model such that the volume of determinations is minimised and focused not on the model itself but only on whether we have used the right inputs into it (type, number, age of assets etc).
- We believe that charges should only be refunded where an Ofgem approved mechanism is in place for the full recovery of the refunded value.

If you have any queries on the above points or on the information contained in the appendix, please do not hesitate to contact me in the first instance.

Yours sincerely

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Regulation Manager

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APPENDIX 1 – QUESTION RESPONSES

CHAPTER: Three – Question 1: Is our description and interpretation of historical charging arrangements (including connection and use of system agreements, charging statements, determinations, regulatory precedents) complete and accurate? If not, please provide supporting evidence setting out any issues that you identify.
Yes.

CHAPTER: Three – Question 2: Do you agree with our rationale for only allowing refunds for instances of double payment to be funded through the price control?
While we agree with the refund of double payments of O&M, there are a number of detailed aspects that need to be considered further – as outlined in the following paragraphs. Furthermore, we believe that where a change in regulatory regime has taken place (i.e. a move from deep to shallowish connection charges), there should be no refund of charges associated with this as no double recovery has taken place. It remains to be clarified by Ofgem what level of evidence will be sufficient to assure UK Power Networks of the ability to recover the refund of O&M through the next price control. A major complication is the lack of project specific cost information. While the typical rates and periods of capitalisation of O&M are known to some degree, without specific project cost information the methods proposed by Ofgem will be impracticable, as there would be no project cost or knowledge of absolute O&M value on which to determine compensation due. We therefore consider that the modelling of expected connection costs based on the MEAV of the sole use assets would be an appropriate methodology in lieu of project cost information. We would expect MEAV values to be sourced from available information such as CDCM/EDCM cost data, RIGs unit costs or quotations from connections designers. We seek Ofgem's support for our proposal as a pragmatic means of ensuring an efficient and pragmatic refund process. We believe that this approach should then lead to costs associated with these refunds being automatically allowed as recovery through the price control. It is also worth noting at this point that in some cases O&M was charged on alternative circuits and switching stations to provide for resilience at the generator's request. In line with connection charging methodologies and use of system charging methodologies some element of O&M would not be paid for through use of system charges. In such cases any refund that may be due would relate only to the cost of works necessary to deliver the minimum scheme envisaged and being supported through use of system charges were they to have applied.

CHAPTER: Three – Question 3: Are there any other instances (beyond that of double payment) where refunds should be funded through the price control? If yes, please explain why these instances are appropriate and compatible with the regulatory regime as it has evolved over time.
We do not believe there are any other such instances but please see also our answer to question 2 above.

CHAPTER: Three – Question 4: Are there any other circumstances beyond capitalised O&M payments that may give rise to instances of double payment that should be reimbursed and funded through the price control? If yes, please explain why these instances are appropriate and compatible with the regulatory regime as it has evolved over time.
We do not believe there are any other such circumstances but please see also our answer to question 2 above.

CHAPTER: Three – Question 5: Do you agree with our proposed approach to calculating refunds for unexpired capitalised O&M payments? Please suggest any improvements to the approach outlined and reasons for these.
In general the proposed approach seems appropriate, although we would draw your attention to the point raised in our answer to question 2 above, relating to the method for actual calculation.

CHAPTER: Three – Question 6: Where DNOs have entered into agreements that are/were inconsistent with regulatory practice (e.g. giving indefinite rights to use of system without further charge or entering into contracts that cannot be freely modified) do you agree that any compensation required by virtue of these contracts should not be funded through the price control?
We believe that all compensation should be funded through the price control. We note, as Ofgem has, that while contracts may in the past have been entitled 'Connection and Use of System Agreements', in most cases there exists a distinct lack of terms expressly setting out the entitlement to make 'use' of the distribution system for distributing energy, conceptually all the way back to the transmission system. In the historical context we believe that the contracts of the time merely enabled connection to the distributor's system and these were therefore in line with standard regulatory practice of deep connection charge, with no payment being made for use of assets all the way back to the transmission system. A charge for use, in the sense of a charge for entry into a competitive market with finite export capability, was not envisaged at the time pre-April 2005 generators were connected. The historical lack of clear terms of 'full' use in contracts with licensed generators, and the absence of any upfront or annualised charges specifically for assets upstream of the highest point of reinforcement back to the transmission system, makes it quite clear that charges for 'use' of the distribution system were not part of the regulatory or connection charge arrangements at that time. We therefore intend to implement comprehensive use of system terms for the relevant licensed generators – through either variation of existing contracts or the termination of existing contracts and the offer of replacement terms. Following the implementation of comprehensive use of system contract terms, we expect that any consequential compensation would be funded through the price control.

CHAPTER: Four – Question 1: In general are our proposals for implementing the refund arrangements considered by this consultation appropriate? Is the level of detail we have provided sufficient to make our proposals clear and workable? Please outline any areas where you think more clarity/detail is required.
The use of MEAV based modelling of compensation where records are not available requires a pragmatic approach from DNOs, customers and Ofgem. Assurances on the acceptability of methods of project cost 're-creation' and their acceptance into recovery through the price control are essential to avoid the need for unnecessary determinations. This answer should be read in conjunction with chapter three, question 2.

CHAPTER: Four – Question 2: In the section on "Consistent application of principles", have we appropriately identified who is eligible for a refund? Do we need to provide any further areas of clarification? Which of the two options outlined for mixed sites (demand and generation) are appropriate?
We agree that Ofgem has made a good assessment of who is eligible for a refund, but would ask that Ofgem notes the increased workload that including HV and LV generators of all sizes entails. We propose that Option 1 – refunding a calculated portion only of the marginal costs (if any) related to the additional export driven costs of the connection – is the most appropriate. It seems inappropriate for a generator to receive a refund of demand-driven O&M where that O&M was not caused on the pro rata basis as set out in Option 2. For example, an existing large power demand connection requiring only minimal protection of interface changes and little or no major asset upgrades to commence export would be excessively compensated if compensation were based on Option 2.

CHAPTER: Four – Question 3: Are the evidence requirements set out in the chapter as necessary to support a case for refunding appropriate? Are they sufficiently robust to prevent ineligible claims for compensation being recovered through the price control? Are there additional or alternative assumptions that could be used for supporting a case for a refund?
In terms of evidence based on known project cost and known O&M policy information, the approach appears sound. Where this information is not available, a standard approach such as the one we outlined in chapter three, question 2 should be used. We believe that no payment should be made until full and final acceptance is secured from the customer (or secured through determination by Ofgem), with both forms of final acceptance resulting in the accepted compensation being allowed into price control recovery.

CHAPTER: Four – Question 4: Is our approach to due process appropriate? Are there additional or alternative steps that should be incorporated?
The distributor, as a consequence of the Supplier Hub principle, does not generally have the current counterparty details for all customers. In order for the distributor to successfully communicate with generators, we believe that either of two approaches would be required. The first would be for the DNO to communicate (in the first instance) to the currently appointed export electricity supplier, to relay the information to the relevant customer. The second option would be for the supplier to provide the customer's administrative contact details to the relevant DNO, to allow direct communication. However, recent attempts using both approaches in respect of Grid Code generator protection requirements led to a very poor response and reluctance on the part of suppliers to relay information or provide the customer's administrative contact details. We believe that regulatory guidance to suppliers on this topic from Ofgem may help.

CHAPTER: Four – Question 5:
We welcome views on how refunds should be paid and the details of implementation. In particular, should it be a one-off payment, a phased payment or a hybrid of the two? If a refund is not a one off-payment, over what time period should it be paid? Do you agree with our proposals for refunds that are not agreed by 1 April 2012?

To guarantee finality and certainty of compensation recovery through the price control, we would be inclined to favour a one-off payment.

However, the potential scope of generator connectees may vary from around 40 to approximately 350* candidates depending on final scope decisions made by Ofgem (i.e. to EHV only or also to HV and LV). The consequence of this decision may materially affect the total level of compensation required to be paid and the feasibility of achieving the 1 April 2012 target.

* While there are approximately 269 export MPANs traded prior to 1 April 2005, the multi-year lead times on construction mean a number of primarily HV and EHV connections would have been quoted under pre-April 2005 terms that commenced trading many years later. Consequently, the number of sites requiring investigation could reach around 350 or so.

CHAPTER: Four – Question 6:
Do you agree with the mechanics for allowing DNOs to recover refunds through the price control?

We agree that all compensation paid, through whatever model is chosen, should be refunded through the price control as it would be inappropriate for a change in licence requirements, on the matter of charging transition to align use of system charging, to be at the cost of the licence holder. Furthermore, the refunding through the price control should include a specific line item in the model identifying these costs including interest.

CHAPTER: Four – Question 7:
Do you agree with our proposals for dispute resolution where DNOs and DGs cannot reach a settlement by 1 April 2012? How can we encourage DNOs and DGs to reach a timely settlement? In particular, should use of system charges in respect of the DG be logged up and back-billed once a refund has been settled on? If these DGs do not have these charges back-billed, how should these charges be recovered by the DNO from other customers?

As per our response to question 6, the sheer practicalities of workload in assessing potentially 350 or so generator connections will dictate how soon we can set out proposals to a specific generator and for each generator. Whether on a first come, first served basis or size or voltage or 'charged' use of system prioritisation, each generator would be communicated with as soon as is reasonably practicable.

In respect of the small volume of licensed generator connections requiring contract terms to be amended to include terms for use of system, we believe use of system charging should commence from 1 April 2012. If this date is not achieved, this will be by a backdated commencement date in the relevant contract and for use of system charging to recover all charges due, backdated, from 1 April 2012 even where contract changes are delivered after that date.

We would expect that commencement of use of system charging would not be deferred pending agreement on O&M compensation, as this would seemingly provide an inappropriate incentive to lengthen negotiations unreasonably and forestall commencement of charging.

More generally, the conclusion of each dialogue and the completion of the compensation exercise are dependent on the agreement of the customer or on the duration of ensuing negotiations or determinations.

Given the likely size of the exercise, were compensation to HV and LV generators being 'paid' use of system deemed necessary, it could take up to the end of 2013 to complete the compensation proposals to the last potential claimant.