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Dear Tony

G3: Structure of electricity distribution charges - joint consultation on the longer term charging framework

energywatch welcomes the opportunity to respond to the issues raised by this consultation. This response is non-confidential and we are happy for it to be published on the ENA website.

General comments

Consumers, particularly the vulnerable, expect network operators to deliver safe, secure and reliable electricity supplies in an efficient and economic manner. However, the vast majority of consumers, who, through their suppliers, use the distribution networks, are passive recipients of network services. The ability of existing users to respond to locational pricing signals based on where they are connected on the networks, either individually or collectively, is non-existent.

Even the largest users, connected at EHV level, will take into account a number of factors prior to connection to the network. For future users, the cost reflectivity of distribution use of system (DUoS) charges where they are connected is likely to be only one factor. Planning issues, transport links and suitability of location amongst others will also be significant, perhaps more decisive, factors, more so than DUoS charges which make up only part of their overall costs.

We note that all electricity distribution network operators (DNOs) are currently considering how best to develop a long-term structure for DUoS charges. The development of a long-term framework helps promote certainty and predictability for users and allows DNOs to plan network investment more efficiently and effectively. For users, DUoS charges must also display the characteristics of simplicity and transparency – the derivation of charges should be easy to understand and accessible.

While DNOs ought to develop the long-term structure of charges in the context of their licence obligations, they must strike a balance between those obligations where these are in conflict. Other long-term considerations also need to be taken into account, not least how to develop actively managed, responsive networks which can accommodate more distributed generation. Energywatch is very supportive of the increased use of distributed generation as there a number of benefits for consumers in having more localised electricity network solutions. More community-based schemes aimed at lowering carbon emissions and increasing energy efficiency – CHP and small renewables targeted at the fuel poor and

vulnerable consumers – have a social benefit and can assist in meeting government objectives for sustainable energy. Local network solutions can more readily meet the needs of those consumers in rural areas. Efficient and economic investment in local networks can also assist in determining the most balanced approach to investment in the networks at all levels.

Specific issues

We are concerned that DNOs are concentrating too heavily on their licence obligation to develop cost reflective charges. As we have already noted, most users at all voltage levels are unresponsive to any pricing signals which may arise – they will simply have to pay the DUoS charges derived through the pricing models. The DNOs must consider how to balance the impact of cost reflectivity against other licence obligations, not least facilitating competition in generation and supply. Small suppliers would, in particular, be disproportionately and adversely impacted if there was a significant and immediate upward shift in their DUoS charges due to the small size of their customer portfolio, charges which they would inevitably pass through in full to their customers. The impact on larger suppliers is mitigated to some extent by their size and ability to hedge extra costs more effectively. Therefore, the adverse impact on competition in supply could affect both existing players and also create an additional barrier to entry for new suppliers.

A further consequence of locational DUoS pricing signals may be that those users who do not connect in the areas where DUoS charges are lower will be penalised. This could have much wider effects on the economy as those users may have to factor in higher energy costs despite their chosen location otherwise being appropriate for their chosen activity. We accept that such users need to pay a fair share towards the costs of connection and use of system. However, we do not believe that increased cost reflectivity necessarily creates fairness for those users.

We also accept that any significant increase in the connection of distributed generation may require an element of cost reflectivity to be built in to the charge for reinforcement works. However, the scope and extent to which, in future, distributed generation may ramp up remains relatively unknown. DNOs should continue to assume average demand growth in the long term and plan network reinforcement accordingly. The nature of actively managed and resilient networks should be to accommodate unexpected load growth in an innovative and efficient manner as it arises rather than prejudice potential levels of reinforcement which could occur.

We have highlighted that cost reflective DUoS charges will not necessarily elicit any response from most users, certainly not existing users. In fact, consumers will be adversely impacted by significant tariff disturbances over short periods due to the pass through of those costs by suppliers. DNOs must be mindful that DUoS charges constitute a larger proportion of the end consumer's bill than transmission charges. It is unacceptable for consumers to be subject to the prospect of higher bills as a result of cost reflective DUoS charging when the significant increases in wholesale costs which have fed through to retail bills over recent years have only recently begun, somewhat modestly, to be reversed. If there are significant tariff disturbances for the majority of consumers, these must be subject to phasing over an appropriate period of time.

G3 proposals

We note that the G3 proposals seek to analyse future reinforcement requirements according to different treatment of demand and generation load growth and also EHV and lower voltage levels. The latter distinction may be less appropriate as we consider that even some EHV users may not be as responsive to cost reflective charging as G3 assumes. We

are also concerned about the flexibility of the approach to reinforcement to accommodate more distributed generation – potentially the incidence of connections at lower voltages may be higher compared to connections at EHV if small embedded generation projects or community projects take off.

We also note that the G3 proposals seek to allow marginal charges to be made to users the more that reinforced capacity is utilised over the 10 year time horizon used for determining, and calculating the recovery of, reinforcement costs. We would query whether this leaves users and consumers who connect much later at a distinct and unnecessary disadvantage. It may be that some users are, in good faith, at the back of a connections 'queue'. Would it be fair to charge them for marginal costs even if this is a more cost reflective approach?

We consider that the cost reflective approach outlined creates additional issues, such as how to appropriately scale costs to allowable revenue and negative charging for generation, which may add more complexity to the calculation of DUoS charges. This does not sit well with the principle of transparency which ought to characterise the charging methodology. In fact, the capping of negative generation charges to zero would actually dilute a pure cost reflective approach. We continue to support the retention of the DRM pricing model for deriving DUoS charges as it best reflects the simple, predictable, certain and transparent method we consider appropriate. We realise that averaging through the DRM is not an ideal solution. However, until the consequences of increased reinforcement to networks, and the associated costs, are better understood in terms of more actively managed and responsive distribution networks, we see no clear incentive to change.

We will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs