

REA response to G3 May 2007 consultation on the longer term charging framework of distribution charges

The REA is pleased to offer its comments on this consultation by a grouping that represents six of the fourteen distribution network areas in Great Britain. We particularly appreciate your attempt to work together as this will result in fewer different methodologies for developers to understand.

Before responding to the some of the specific questions asked we make two general points. Firstly, it is important to consider the charging structure in the long term and therefore it is unfortunate that you feel constrained to make it fit into the price control arrangements that are set to expire in 2010. In particular the separate price control allowance for generation makes you feel constrained to disallow negative charges for generators that defer the need for reinforcement (paragraph 5.26) on the grounds that this would necessarily impose costs on other generators. Obviously we consider the result to be undesirable and we consider it would be helpful when considering the methodology to produce the indicative charges that would apply without this restriction.

Paragraph 2.16 states that "The DNOs acknowledged that choice of a revenue reconciliation method or methods is vital to ensuring minimal distortion of marginal costs." As the reason for this is to provide the maximum influence on those parties that can take note of the price signals, it would seem logical to minimise the distortion of marginal costs for such parties. The REA favours a Ramsey pricing approach, or perhaps for simplification, applying no distortion to certain categories of connectees, such as generators. It is clearly acknowledged that well-located, new generation will actually save future investment and this should be reflected in charges, (as should demand in "generation full" areas).

We now address the some of the detailed questions asked.

Chapter 3 - Forecasting Future Reinforcements

Views are invited on the following:

- The different approaches to demand and generation.
- Is analysis at the Network Group level appropriate?
- Is the approach of incrementing demands in 1% steps up to 15% and undertaking contingency analysis at each step reasonable?
- Is one year of actual cost data sufficient to produce forecasts for HV and LV reinforcement costs?

We think that one has to be very careful about the different approaches to modelling demand and generation. The consultation document appears to assume that all generation will be large and lumpy, and all demand small and non-lumpy, whereas this is not necessarily the case.

We think that the Network Group level of analysis is appropriate in the majority of cases but may need to be modified for areas of the network, e.g. where the next reinforcement may be to operate interconnected with another group or reinforce and split up a group that is currently run as such.

Incrementing demand in 1% steps clearly represents the effect of demand growth at HV and LV rather than new EHV demand connections

Chapter 4 – Determining forward looking costs

Views are invited on the following:

- The approaches to determining demand and generation marginal costs. The time periods that should be used for determining costs. Is the approach for determining growth rates, and particularly the method of adjusting for embedded generation to determine underlying demand growth, appropriate?
- Is the 10 year time horizon for considering network reinforcements and the associated cost recovery period a reasonable approach?
- Should the 10 year cost recovery period used for demand be used for generation also, or should the 15 years assumed for generation in the distribution price control be used instead?
- Is the mechanism for determining charges in each of the time periods appropriate?
- Should uniform generic values of the P2/6 contribution factors be assumed? If not, should they vary by type of generator or by region (taking account of the type of generator that is more likely to connect there)? Should actual contribution factors be determined from historical output data for existing generators where this is available? For lower voltage levels should voltage level averages be used?
- Is the approach of using a typical generator size in determining the marginal cost appropriate?

The approaches to determining demand and generation marginal costs are not unreasonable in outline and we agree that a ten year look ahead period is an acceptable compromise between volatility and accurate forecasting.

We also think that increasing the weighting attached to future reinforcement as it gets closer and therefore more certain, is the correct balance between reflecting the lumpiness of reinforcement and providing a degree of smoothing of charges over time.

We agree with the approach taken to assessing charges for EHV-connected generators. As stated in paragraph 4.10, there is a need to ensure that generator connection is not discouraged if it can be achieved at no cost. It is important however to check that the methodology does not result immediate positive use of system charges as soon as additional generation has used up the spare capacity.

In assessing the benefit of generation in deferring reinforcement the P2/6 factors are probably rather pessimistic. It could be argued that it would be more appropriate to treat generation at LV as negative demand, with perhaps a derating factor to account for the probability of the generation not being available during demand peaks. It is not consistent to use P2/6 derating factors when assessing the deferment of reinforcement, but not when assessing the need for generator-driven reinforcement.

Chapter 5 – The G3 tariff model

Views are invited on the following:

- Is one year of actual cost data sufficient to produce forecasts of operation and maintenance and refurbishment costs?
- Is the proposed revenue reconciliation approach of applying a different ‘adder’ to each voltage level in proportion to MEA value appropriate?
- Should negative charges be permitted?
- Would it be appropriate to cap site specific EHV charges at the level of the equivalent generic HV charges to avoid perverse incentives at the boundary
- and, if so, should this be done before or after allocation of sole use asset costs to EHV charges?

Our general view is that charges for generation should differ as little as possible from the identified marginal costs and therefore we will not comment in detail on the method of getting from the marginal costs to actual charges. We maintain for instance that in areas where there is an excess of demand over generation, refurbishment costs should not be attributed to generation as increasing amounts of generation would reduce the need for this refurbishment.

We stated earlier that negative charges should be permitted but recognise that this would cause problems during the current price control period.

Chapter 6 – Other charging issues

Views are invited on the following:

- Where a single set of sole use assets support more than one metering point - for example import and export metering points sharing the same physical connection - how should the cost of these assets be shared?
- Is the proposed approach to the sole use assets O&M charge set out in 6.1, or the alternative methodology set out in 6.2, more appropriate?
- What should be the nominal life of sole use assets – should this align with the 10 years used for reinforcement, or mirror the expected asset life of, say, 40 years?

We prefer the more cost-reflective method of charging for O&M of sole use assets given in paragraph 6.2, notwithstanding its greater volatility. The capital contribution on sole use assets should be based on their expected life rather than 10 years. The latter period is utilised as a window for reasonable certainty of future reinforcement. Sole use assets are already there so there is no question of uncertainty and they should be charged over their useful life.

Finally on this chapter we note the comments on charging demand for excessive reactive power. We support this and point out that it follows that optimum use should be made of the reactive power capability of some types of generator and this should be exploited and paid for, in the same way as excessive consumption is charged for.