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Department of Energy and Climate Change
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By e-mail and post

Dear Mr[redacted]

Consultation Ref: 10D/818 - Provision of third party access to licence exempt electricity and gas networks

I write on behalf of Heathrow Airport Ltd (HAL) in connection with the above consultation paper published on 19 October 2010. HAL is the owner of substantial licence exempt electricity and gas networks used to supply energy to a large number of its customers. In 2009 HAL supplied in excess of 190GWh of electricity but less than 300MWh of gas to customers.

HAL's comments are as follows.

General

HAL supports the retention of the self-certified class exemption regime for licence exempt electricity and gas networks (hereinafter "private networks"). However, despite self-certification eliminating the administrative burden and regulatory costs associated with licensing, HAL is concerned that the substance of DECC's current proposals will significantly increase the regulatory burdens and associated costs of private network operators (PNOs).

Secondly, HAL has great concerns that there are large areas of uncertainty in the practical application of third party access (TPA). These uncertainties are likely to result in time-consuming and expensive disputes. HAL urges DECC most strongly to minimise the opportunity for disputes.

HAL also has concerns that, without appropriate transition arrangements, the implementation of TPA may significantly increase PNOs' commercial risks over the short term.

Regulatory Burden

Under Part IV of the Airports Act 1986, the UK Civil Aviation Authority (CAA) is responsible for the economic regulation of HAL. The CAA does this through setting price controls and other conditions on the operation of HAL every five years. The CAA's purpose in its economic regulation of HAL includes the promotion of "...timely investment in capacity to meet demand... [to] limit the amount of revenue which each airport can raise from airport charges and create incentives on the airport operator to operate efficiently, to invest in response to users' needs..."[i]

The CAA therefore scrutinises HAL's investments in all essential infrastructure necessary to provide HAL's capacity to meet demand, including HAL's private networks. If Ofgem, in effect, becomes responsible for economic regulation of HAL's private networks this duplicates existing regulation and there is a significant risk that divergent objectives and incentives will arise from different regulators.

Moreover, HAL is also concerned that a lack of clarity in regulatory jurisdiction would result in jurisdiction "tourism" whereby TPA customers or suppliers may choose to resolve disputes with PNOs either through Ofgem or through the CAA (or perhaps even both) in the hope of exploiting differences in approach.

HAL therefore requests that absolute clarity is provided on this issue and proposes that:

1. Regulated Airports (within the meaning provided by the Airports Act 1986) would be free to choose to recover private network infrastructure investment through:
    a. use of system (UoS) and other customer-driven network charges (e.g. connection charges) levied directly on customers or on or through TPA energy suppliers; or
    b. non-aviation charges recovered under the Airports Act 1986; or
    c. subject to safeguards preventing double-recovery, any combination of a) and b) above;
2. Ofgem's role should be limited to scrutiny only of such recovery through UoS and other direct network charges; and
3. the CAA's role should be limited to scrutiny of such recovery through non-aviation charges.

HAL believes that a so-called "shallow" connection charging methodology should be adopted (see below) and this may require the hybrid approach implied by option 1.c. above.

Costs Recovery

As a general principle, HAL would prefer direct charging (as opposed to pass-through) of upstream energy costs not associated with PNO infrastructure. Thus, TPA suppliers would, in addition to wholesale energy costs, invoice all BSUoS, TNUoS, DUoS, feed-in tariffs and meter operator charges, etc. associated with a TPA customer's consumption (and the gas industry equivalents), as well as climate change levy and future liabilities under the Carbon Reduction Commitment and the EU- Emissions Trading Scheme plus any other taxes or charges.

HAL believes all existing licensed energy suppliers have systems and procedures for capturing the necessary data and billing these charges, whereas the vast majority of PNOs do not.

Metering Arrangements

The consultation paper sets out three potential alternatives to full settlement metering. However, it is unclear whether two of the options (deemed metering and 'Opt in/Opt out') are compatible with the Balancing and Settlement Code. In HAL's view there is also significant uncertainty and consequent opportunity for dispute over how electrical losses within private networks would be treated for such purposes.

The third alternative to full settlement metering (a commercial agreement - presumably involving the PNO, the TPA supplier and the customer) presumes that such a three-way agreement can be reached in sufficient time to facilitate the transfer of a customer to a TPA supply. However, if customers have an absolute right to switch in three weeks, this time constraint and the inherent complexity of three-way negotiations is only likely to militate against such agreements and thus

lead to disputes. There are also manifest problems decoupling customer consumption from any effective economic signal for it. For these reasons HAL is not confident that a commercial agreement is practical in most cases.

As was stated above, HAL's view is that TPA customers and suppliers should be responsible for TNUoS and DUoS, etc., charges associated with TPA customers' own consumption. This would naturally include those charges linked to maximum demands such as so-called "Triad" and "Availability" charges. HAL's opinion is that disaggregation of these charges requires full settlement metering under the Transmission and Distribution Codes.

For these reasons it is HAL's view that full settlement metering to all TPA supplies is the only practical method for billing TPA supplies. Moreover, the cost of metering is so low that it is difficult to understand how it could be viewed as a significant barrier to competition.

There is a further consideration with respect to metering: meter reading. HAL has a large number of customer supplies (perhaps 1000 or more) where settlement metering is or would need to be physically located in secure "airside" areas. In the worst case: i) such meter reading may be carried out in monthly intervals; ii) each TPA supply contract is likely to have meter reading intervals that are staggered with respect to other TPA contracts; and iii) different TPA suppliers are likely to use different meter reading entities. As a result, HAL is concerned that it could have hundreds of separate visits each month by meter reading operatives.

In order to gain unaccompanied access to secure areas HAL's contractors and their employees are required to undergo stringent and time-demanding clearance processes. HAL believes that giving such access to secure areas to several different contractors, each with many different meter readers is highly sub-optimal from a security perspective. In any event, this may not be practicable at all if high staff turnover exists in such companies. Thus, HAL is concerned that it may incur substantial costs (perhaps more than £1m per annum) if it needs to escort TPA meter readers in secure locations.

HAL proposes two potential solutions to this problem, both of which could be subjected to a reasonableness test. The first is that PNOs could require TPA supplies to have automatic meter reading (AMR). HAL believes that the benefits of AMR frequently outweigh the costs. This would be especially true at HAL if HAL's costs of escorting meter readers are taken into consideration.

Alternatively, PNOs could recharge the costs of either escorting meter readers or arranging meter reading activities themselves. HAL believes, however, that this option will carry a high administrative overhead and it would be simpler and less expensive overall for AMR to be installed in secure locations.

Embedded Private Networks

HAL is in a potentially unusual situation with regard to the majority of its private electricity network as this is largely embedded within another private network owned by UK Power Networks Services Limited (UKPNS). This situation arose in 1993 when HAL sold its high voltage distribution network to London Electricity Services Limited (as UKPNS then was) but retained ownership of its medium and low voltage networks.

Despite the change of responsibility for high voltage infrastructure, since that time HAL has retained responsibility for the supply of electricity to all customers, including those taking a supply directly from the UKPNS network. As a consequence, there are some instances where there is no pre-existing contractual relationship between the PNO to whose network a customer is attached and that customer. From the consultation paper HAL presumes that it is DECC's intention that there will now be a direct relationship in such instances.

HAL requests clarity on the following:

- Will the "relevant" PNO for the purpose of providing TPA be determined by the point of connection?
- Where there is no pre-existing contractual relationship what is the legal status of any new relationship between a "relevant" PNO and a TPA customer?
- As a consequence, will connection agreements require introduction or would they be deemed to exist? How, practically, might any such "agreements" be introduced and in what form?
- How would embedding one private network within another affect or be affected by the concept of closed networks?

Connections

In situations where new infrastructure has to be provided, or investment has to be undertaken in existing infrastructure to reinforce integrity or augment capacity for PNO connectees, the incremental investment costs need to be recovered in an appropriate way. This can be through connection charges and/or general infrastructure charges.

HAL proposes a "shallow" connection charging policy combined with general infrastructure charges to recover upstream reinforcement costs. This support is based on the following arguments:

- charges should reflect the long-run cost of making network capacity available for use by customers. "Deep" connection charges tend to reflect short-run network costs.
- charges should be equitable. Deep connection charges routinely result in major disparities between treatment of connectees.

In any such implementation there must be rules defining the boundary between 'shallow' and 'deep' network assets. HAL would prefer to see a reasonably narrow definition of 'shallow' network assets, in line with the definition used for the UK electricity transmission system. This definition would include only those assets which, at the time of construction, are to be used exclusively by the connectee or are to be shared between a clearly identified group of connectees.

HAL requests clarification of how connections policy would be affected where there are embedded private networks.

Infrastructure Charges

As a general principle HAL supports infrastructure charging policies that provide incentives for future asset investment. HAL and its commercial partners have invested very significant sums to provide their existing private networks and there is thus spare capacity available at various points of the networks for third-party use. Consequently the marginal (or incremental) costs for operating the infrastructure will be below average costs. HAL believes that average cost pricing is appropriate as this encourages further investment and is consistent with a shallow connection charging policy.

Obligation to Supply

HAL supports the principle of customer choice in utility markets. However HAL also supports the extension of this principle to PNOs. Therefore, HAL proposes that a PNO should have the freedom to choose whether to offer to supply energy to its customers. In other words, a PNO could withdraw from what some might regard as a non-core activity and require customers to make their own

commercial arrangements for the supply of energy, unless in the case of particular supply points there is a specific technical reason that prevents TPA (e.g. the "hotel room" scenario identified at paragraph 2.8 of the consultation document).

Within that context HAL requests that DECC provide clarity on the following:

- Who is the supplier of last resort?
- Where incoming supplies are experiencing an outage, if its network has standby generation would a PNO be obliged to provide energy to a TPA customer? If so, how could/would PNOs charge for providing this service?
- What requirements will be placed on TPA suppliers and PNOs where a disconnection is to be effected as a consequence of a customer breaching its supply agreement?

Dispute Resolution Procedures

In addition to the clarification requested above regarding regulatory jurisdiction, HAL also requests that DECC consider Ofgem's primary role in resolving disputes. HAL is concerned that Ofgem will not be adequately resourced and thus will be unsuitable to provide a front-line dispute resolution service for what may prove to be a "bow-wave" of disputes once TPA is implemented. HAL therefore requests the implementation of a fast and inexpensive method of first instance dispute resolution. In line with adjudication in the construction industry such an alternative dispute resolution method could be "interim binding" pending final resolution via Ofgem.

Debt Recovery

The consultation envisages that all unbilled volumes of energy will be "reconciled" before a TPA transfer is effected. HAL proposes that such reconciliation is subject to the safeguard that PNOs remain able to disconnect supplies in the event of non-payment of properly invoiced reconciliation sums. HAL additionally requests that adequate protection is given to the rights of PNOs to recover any further sums that would properly be recoverable but which were otherwise not included in any reconciliation invoice issued prior to a TPA transfer. In other words, unless the parties agree otherwise, such a reconciliation payment should not necessarily be full and final in respect of all contractual liabilities.

Timing and Transitional Arrangements

HAL is concerned regarding the timing of implementation of TPA. It is common practice that PNOs enter into long-term (3 to 5 years) contracts for the bulk purchase of energy. It is a frequent feature of such agreements that a PNO undertakes to purchase a minimum volume of energy. This minimum volume is likely to have been agreed on the basis of the expected aggregate of the PNO's own and its customers' requirements. If such existing "take-or-pay" commitments cannot in the future be met because a customer exercises its TPA right to purchase energy in the wider energy marketplace this may expose a PNO to the liability to pay for energy bought in good faith on behalf of its customers.

Further, HAL has of the order of 10,000 separately metered supply points, a significant proportion of which have meters that are still manually read. Meter reading at HAL is carried out by a contractor appointed under a long-term agreement. If TPA reduces work volumes significantly this may expose HAL to compensation claims from that contractor.

As well as the commercial risks illustrated above HAL is concerned that there are reputational risks. If implementation is rushed and the transition not smooth, the disruption that might follow could cause considerable reputational damage to HAL. To date in 2010, HAL has had to make very great effort to manage the adverse reputational effects for HAL of a number of disruptive events outside its control. These have included, among other things, industrial action in major airline partners and the closure of UK airspace in early 2010. HAL requests that TPA is implemented in a way that minimises the risk of disputes that could *in extremis* lead to disruption.

It is thus our view that the implementation of TPA should, as a minimum, be delayed for such time as there are no major areas of uncertainty in the application of the "rules" of TPA. Moreover, implementation should also not take place until existing contractual commitments can reasonably be expected to have expired. HAL's preference is for implementation of TPA to occur no earlier than April 2014. If implementation does occur before that time, HAL proposes that PNOs should be able to recover any liabilities that arise under pre-existing contracts and which crystallise directly as a consequence of TPA).

Export Rights

HAL foresees practical engineering and commercial difficulties where a customer exports energy from its own generation equipment via embedded private networks. HAL therefore requests clarification from DECC regarding the issues that arise where this occurs.

I thank you for inviting our response to your consultation and trust that you will give due consideration to HAL's views.

Yours sincerely,

Endnote: [1] Economic Regulation of Heathrow and Gatwick Airports, 2008-2013, CAA decision 11 March 2008