Promoting choice and value
for all gas and electricity customers

Guidance on third party access charges for licence exempt gas and electricity distribution networks

Final decision

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Overview:

Some consumers are connected to electricity and gas networks that are exempt from the need to hold a licence to distribute and supply power. In the past such networks did not have to provide third party access to their networks. This has meant that customers connected to these networks have not generally been able to choose who supplies their electricity and gas.

New requirements to allow certain customers connected to these networks to choose their supplier came into effect on 10 November 2011. Amongst other things, the arrangements mean that the owners of licence exempt networks have to have in place a charging methodology approved by Ofgem if the customer requests the right to choose an alternative supplier. The charging methodology does not set out network charges but the basis on which charges are calculated and set. The new arrangements also allow the networks to recover the costs of a new or modified connection to their network where this is required to allow customers to choose their energy supplier. Under the new arrangements, disputes about these connection charges can be referred to us for determination.

This document sets out our decision on the charging principles we will apply to assess these new charging methodologies. It also provides guidance on the content of these methodologies and the process we will use to approve the charging methodologies.

Context

Licensed network operators are required to allow customers to obtain third party supply of gas or electricity, known as third party access (TPA), through obligations under the Gas Act 1986 (the "Gas Act") and Electricity Act 1989 (the "Electricity Act") as well as through their licences. Prior to the implementation of new legislation, licence exempt distribution network operators (ENOs) in Great Britain were, unlike licensed networks, not obligated to enable third party supply.

Following the May 2008 European Court of Justice's ruling in the *Citiworks* case (*Citiworks AG v Flughafen Leipzig/Halle GmbH* (Case C-439/06)) it is clear that the requirement to enable third party supply applies in respect of all distribution systems, and that it is not open to Member States to exempt certain types of system unless a specific derogation has been granted under the relevant EU legislation. The requirement to allow TPA is set out in Article 32 of the Gas and Electricity Directives[1] ("the Directives") which forms part of the EU's Third Energy Package of legislation.

The UK Government will implement the TPA requirements as part of its implementation of the Third Energy Package of legislation. It will do this through a combination of changes to domestic legislation and licences. The implementation of the Directives makes provision in legislation for ENOs to charge suppliers for use of their network and to have their charging methodologies approved by Ofgem, as the National Regulatory Authority for Great Britain. On 18 July 2011 the Government published draft amendments to the Electricity and Gas Acts which implement the requirements with regard to ENOs, under the Electricity and Gas (Internal Markets) Regulations 2011. The legislation came into force on 10 November 2011.

Associated documents

DECC Draft Guidance: Provision of third party access to licence exempt electricity and gas networks, 14 October 2011

Guidance on third party access charges for licence exempt gas and electricity distribution networks, 20 December 2010 (Ref:166/10)

DECC: Consultation on the provision of third party access to licence exempt electricity and gas networks, October 2010

[1] Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in gas and Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity repealing Directive 2003/54/EC.

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Executive Summary

Under new arrangements customers connected to networks that are exempt from the need to have a licence to supply and distribute electricity and gas can, under certain conditions, choose who supplies their gas and electricity. Exempt networks typically cover ports, airports, caravan parks, district energy schemes, industrial production sites and trading estates. The new arrangements allowing third party supply are known as third party access ("TPA").

TPA is required under EU legislation. The EU requirements are accommodated in The Electricity and Gas (Internal Markets) Regulations 2011, (the "Regulations")[2]. The Regulations require licence exempt distribution networks to allow third party supply on their networks. The Regulations came into force on 10 November 2011 and they also amend the Gas Act and the Electricity Act in certain respects to allow for TPA.

Under the Regulations customers on exempt networks who wish to change supplier must provide evidence that a third party supplier is willing to supply them gas or electricity. The licence exempt distribution network operator ("ENO") (referred to in the legislation as the distribution exemption holder) must then produce a methodology for charging for use of its distribution system. The methodology is required only where use of system charges are levied separately from other (e.g. property rental) charges. The ENO's charging methodology statement[3] has to be submitted to Ofgem for approval.

This document sets out guidance for ENOs to put together a charging methodology statement and sets out the process we will use to approve charging methodologies. Our decision and guidance follows our December 2010 consultation on TPA.

Our decision is that the ENO must demonstrate that two principles are met in its methodology. The principles are that:

- the resulting tariffs must be justified by reference to the costs of the distribution network, and
- costs must be allocated to individual network users on an objective, justifiable and non-discriminatory basis.

These principles follow EU legislative requirements. We explain our reasoning for our decision on these principles in this document. The document also provides guidance on the information an ENO could provide in their charging methodology statement to meet the charging principles.

In this document we have additionally set out a pro forma template of a charging methodology statement to assist ENOs in developing the methodology. The pro

[2] http://www.legislation.gov.uk/ukdsi/2011/9780111513965/contents
[3] This is referred to in the legislation as the charging statement containing details of the proposed methodology for calculating the use of system charge.

forma has been populated as an example of how it could be completed prior to submission to us.

We will take a proportionate approach to approving the methodologies. For larger ENOs, depending on their circumstances, this means we would prefer a greater level of detail underpinning various items than is included in the example set out in the pro forma, where they have the resources to provide this information. This includes the identification of network costs, how the costs have been allocated to customers and detail on factors that are likely to affect network charges in the future, particularly where the impact of the charging methodology is likely to affect a significant number of customers. For very small ENOs with one or two small customers we would not necessarily expect them to provide the level of detail contained in our pro forma.

We may therefore require additional information, if it has not already been provided, from certain ENOs before we are able to approve their charging methodology statement. We recognise that it may be appropriate to revise our guidance to clarify what we require from larger and smaller ENOs and what the definition of a large or small ENO is once we have had experience of approving the charging methodology statements.

Our guidance is not prescriptive and any other reasonable and proportionate methods of identifying network costs and allocating them to customers are likely to be acceptable for the purposes of approval. ENOs should note that only costs relating to the distribution of energy across a specific network can legitimately be recovered through approved use of system charges.

The Regulations require us to approve use of system methodologies as soon as is reasonably practicable. We will endeavour to provide this decision on approval within one month of receiving the submission, subject to the number of submissions we receive and the time it takes to receive any additional information required to make our assessment.

In addition to use of system charges, ENOs can recover the costs of connecting the new supplier for a customer requesting TPA. Connection costs are generally the incremental costs of providing the physical connection to a distribution network. We do not approve these charges, but a dispute about the connection charges may be referred to us. As we do not have experience of determining a connections dispute on a licence exempt network we have not set out in this document how we will determine a connections dispute. Once we have some experience of this we can consider whether we need to provide guidance on this.

As Ofgem's experience of approving charging methodologies and determining connections disputes has been limited to licensed network operators to date we intend to review this guidance document after 12 to 18 months to reflect our experience of approving charging methodology statements and handling disputes for ENOs. In the meantime we will work with the ENOs to ensure that their charging methodologies meet the charging principles and provide sufficient information for parties to understand the basis of their charges. It is likely that the feedback from these ENOs during this interim period will inform any updated guidance.

1. Introduction

Chapter Summary

In this section we summarise the requirements of the Directives and the legislation as it relates to Ofgem's obligations. We also provide a brief overview of our December 2010 consultation on guidance on charges for licence exempt distribution network operators (ENOs) (known in the Regulations as distribution exemption holders) and a summary of respondents' views. A more detailed set of respondents' views can be found in Appendix 3.

Third Party Access requirements and network charges

Introduction

1.1. The requirement to provide third party access to distribution systems is set out in Article 32 of the Directives. Third party access to energy infrastructure can be categorised as either:

- customers being able to use a system that they do not own or control in order to transport gas or electricity purchased for their own use or for resale, or
- suppliers being able to use a system that they do not own or control in order to transport gas or electricity for sale to customers.

1.2. More information on the broader requirements for exempt ENOs resulting from Article 32 and other aspects of the implementation of the Directives can be found in the Regulations[4] and the draft DECC guidance on their implementation[5]. In this document we focus on the implications of the implementation of the Directives' requirements for exempt network use of system charging and more broadly on Ofgem's obligations in relation to the legislation.

Requirements of Directives

1.3. Article 32 of the Directives requires that a system of third party access to the distribution system be based on approved methodologies, applicable to all eligible customers and applied objectively and without discrimination between system users. Other articles applicable to network charging are Articles 28, 31, and 37 of the Electricity Directive and Articles 28, 31 and 41 of the Gas Directive.

[4] http://www.legislation.gov.uk/ukdsi/2011/9780111513965/contents
[5] DECC Draft Guidance: Provision of third party access to licence exempt electricity and gas networks, 14 October 2011.

1.4. Article 41 of the Gas Directive and Article 37 of the Electricity Directive (Duties and powers of the regulatory authority) require that all methodologies for network charging are approved by the National Regulatory Authority (for GB this is Ofgem) before they come into force. Under Article 28 closed distribution systems ("CDS")[6] may be exempt from the requirement to have a published methodology approved before it comes into force. Article 30 requires that ENOs must keep separate accounts relating to their energy distribution activities.

Requirements of Legislation

1.5. On 18 July 2011 the government published the draft Regulations, which amongst other things, amend the Electricity Act and Gas Act to implement the requirements of the Directives. The Regulations insert into the Acts new schedules which introduce a number of new obligations on ENOs. Regulation 20(2) inserts new schedule 2AA to the Gas Act and Regulation 21(2) inserts new schedule 2ZA to the Electricity Act. Below we summarise the obligations that are the most relevant to our obligations in relation to use of system charges, settling connections disputes, settling lack of capacity disputes and determining whether an ENO is a CDS.

Use of system charges

1.6. The draft legislation defines a Use of System ("UoS") charge as being a charge for "use of the exempt distribution system". Where the ENO intends to impose a separate charge for UoS it must, within 20 working days, following receipt of an expression of interest[7]:

a) prepare a record of the assets and liabilities associated with its distribution activities at the time of the receipt of the expression of interest;
b) prepare a statement (a "charging statement") containing details of the proposed methodology for calculating the use of system charge;
c) provide the Authority with;
    a. the charging statement,
    b. any evidence that the distribution exemption holder may wish to provide in support of the methodology proposed for calculating the use of system charge,
    c. a copy of the expression of interest, and
    d. such other information or documents as the Authority may request;
d) provide the relevant third party with a copy of the charging statement[8].

1.7. The legislation provides that all UoS methodologies must be approved by us before they come into force. We are required to approve methodologies as soon as

[6] Broadly CDSs are distribution systems that are mainly for distribution of energy to non-domestic customers within a geographically confined area. For more information on CDS refer to the draft Regulations and DECC guidance.
[7] An expression of interest is where a party has expressed an interest to the exempt operator in having TPA and has provided evidence that at least one third party energy supplier would be willing to supply them.
[8] Paragraph 5(2) of the schedules.

is reasonably practicable. If the ENO wishes to change its charging methodology it must also seek Ofgem approval. The legislation makes clear that not having had a charging methodology approved is not grounds for refusing to grant TPA. Where a methodology has not been approved ENOs can recover back-dated approved charges subsequent to approval.

1.8. We approve the statement containing the methodology and not the charges themselves. This means that new methodologies do not have to be submitted every time charges change because, for example, of changes in the costs of the distribution activity. It is the responsibility of the ENOs to calculate charges in accordance with their methodology. The legislation provides that a use of system charge must not be imposed by an ENO unless the Authority has approved the methodology for calculating that charge[9].

Accounts

1.9. Where it is providing TPA and so long as it imposes a separate UoS charge the ENO must keep separate annual accounts relating to its energy distribution activities[10]. These accounts must:

a) be sufficient to show and explain the transactions of the distribution business, separate from any other transactions of the distribution exemption holder's business;
b) be sufficient to disclose with reasonable accuracy, at any time, the financial position of the distribution business at that time;
c) contain entries from day to day of all sums of money received and expended in the course of the distribution business and the matters in respect of which the receipt and expenditure takes place; and
d) contain a record of the assets and liabilities attributable to the distribution business.

Connections

1.10. Where providing TPA requires a new connection to be made between the exempt network and a customers' premises, the legislation allows that the exempt operator may recover "any expenses reasonably incurred in making the connection"[11].

1.11. The requirement for the ENO to make a connection is limited to the extent that:

[9] Paragraph 5(1) of new schedule 2AA of the Gas Act and new schedule 2ZA of the Electricity Act.
[10] Paragraph 6 of the above schedules.
[11] Paragraph 8 of the above schedules.

a) the ENO is prevented from doing so by circumstances outside its control;

b) circumstances exist by reason of which the connection would or might involve danger to the public, and the ENO has taken all reasonable steps to prevent the circumstances from occurring and to prevent them from having that effect; or

c) it is not reasonable in all the circumstances for the ENO to be required to do so.

1.12. Other points relating to network connection from the legislation that other parties might like to note are:

- the duty to offer connection includes a duty to maintain that connection[12],
- the duty to offer connection is limited to the duty to connect a third party supply to an existing customer on the network, and
- ENOs are able to request any terms from parties wanting connection that might be reasonable in the circumstances[13].

Closed distribution systems

1.13. The legislation allows Ofgem to classify certain gas and electricity distribution systems as closed distribution systems ("CDSs")[14]. ENOs who wish to be classified as a CDS must apply to us to be classified as such. Being classified as a CDS means the ENO does not need to have their methodology for charging for use of system approved by us unless the customer or third party supplier requests this[15].

Third party access – lack of capacity provisions

1.14. The legislation permits the ENO to refuse the third party supplier access to its distribution system on the grounds of lack of capacity if:

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[12] Paragraph 7(5) of the above schedules.
[13] Paragraph 9(3) of the above schedules.
[14] We are able to classify a distribution system as a CDS if it satisfies all of the following criteria:
(a) the distribution system is not used for the purpose of supplying electricity (gas) to household customers, or is used to supply fewer than 50 household customers who—
(i) are employees of, or work for or otherwise render services to, the distribution exemption holder or a person related to the distribution exemption holder; and
(ii) take a supply of electricity (gas) that is wholly or mainly from a generating station (gas production site) embedded in the distribution system;
(b) the distribution system is wholly or mainly used for distributing electricity (gas) within a geographically self-contained industrial, commercial or shared services site and is not integrated with any distribution system (pipe-line system) operated or controlled by an electricity distributor (gas transporter), or any transmission system operated or controlled by the holder of a transmission licence; and
(c) the distribution system is wholly or mainly used either—
(i) by system users whose businesses, for technical or safety-related reasons, have operational or production processes that are integrated with those of other system users of that distribution system; or
(ii) for the purpose of supplying electricity (gas) to premises owned or occupied by the distribution exemption holder or by a person related to the distribution exemption holder.
[15] Paragraph 14(1) of the schedules.

- it is not technically feasible to provide the increase in capacity in question, or
- providing that increase in capacity would have a significant and adverse economic impact on the distribution exemption holder or any other person[16].

1.15. If the third party supplier has a contract with the customer to supply gas or electricity the third party supplier can apply to the Authority to determine whether the distribution exemption holder is entitled to refuse access on the grounds of lack of capacity[17]. We can, at the request of the third party supplier, ask the distribution exemption holder to provide information regarding what would be required to reinforce the system to provide the necessary capacity and the exemption holder can recover the costs from the supplier of providing this information. In determining whether the distribution exemption holder is entitled to refuse access, the Authority must decide whether:

- the distribution exemption holder would need to increase the capacity of its distribution system in order to give the third party supplier access to it, and
- it is not technically feasible to provide the increase in capacity, or the benefits of the increase in capacity would be outweighed by the economic impact that the provision of the increase in capacity would have on the distribution exemption holder or any other person.

Dispute resolution

1.16. The Regulations also require Ofgem to resolve access disputes arising out of complaints made against a distribution exemption holder[18].

Our consultation

1.17. In December 2010 we published a consultation on draft guidance on network changes for ENOs and our process for approving these. The guidance covered:

- a high level principles-based methodology that ENOs could opt to use to assist in putting together their use of system charging methodology,
- the principles on which we will base the approval or otherwise of any methodology submitted to us for approval,
- some guidance on the elements that exempt operators should consider when developing a methodology,
- the process for approving use of system charging methodologies, and

[16] As set out in paragraph 1(5).
[17] As set out in paragraph 3.
[18] Regulation 28 amending sections 27 B, 27C and 27D of the Gas Act and Regulation 29 amending sections 44B, 44C and 44D of the Electricity Act.

- some guidance on what might constitute reasonable connection expenses.

1.18. In Appendix 3 we provide a more detailed summary of responses to our consultation. Respondents broadly raised issues regarding:

1. The prescriptive nature of the charges we set out in the consultation document.
2. Greater clarity regarding what can be included in the use of system charges.
3. Clarification on the duty to connect and lack of capacity obligations.
4. Commitment from Ofgem to a timeframe for approving methodologies.
5. Implementation of TPA and in particular questioning timescales as well as the obligations for TPA implementation.

1.19. In chapter 2 of this document we set out our decision on charging principles along with clarification on points 1 and 2 above. Chapter 3 provides more detail on a suggested charging pro forma. We have set out the legislative requirements of the duty to connect and lack of capacity obligations earlier in this chapter and we provide further guidance on what may constitute a connection charge in chapter 4. We provide more information on the timeframe for approving methodologies in chapter 5. We are unable to comment on implementation issues as they are outside of our remit.

2. Use of System Charging Methodologies

Chapter Summary

This chapter sets out how we intend to evaluate use of system charging methodologies.

Introduction

2.1. In this section we set out our decision on the principles that we will use to assess charging methodologies submitted to us. We also provide guidance on submitting charging methodology statements. An example of the pro forma that ENOs can complete is contained in Appendix 1. We used an excel spreadsheet to calculate the costs in the pro forma. To the extent that ENOs wish to understand how these costs were calculated we have included the excel spreadsheet in Appendix 2. A blank pro forma template and excel spreadsheet can be found on our website alongside this guidance document if ENOs wish to use them.

2.2. We intend to take a proportionate approach to approving the methodologies. For larger ENOs, depending on their circumstances, we would need a greater level of detail in their submission than is given the in pro forma example where they are able to provide the information and this chapter sets out what this information might include. For very small ENOs with one or two small customers we would not necessarily expect them to provide the level of detail contained in our pro forma.

2.3. We intend to review this guidance document in the next 12 to 18 months, once we have experience of approving charging methodology statements with a view to providing clarity on what a large ENO is and updating the information we would expect them to include in the charging methodology statement. In the meantime we may seek further detailed information, if it has not already been provided, from certain ENOs before we approve their charging methodology.

Ofgem's decision on the charging principles

2.4. In approving charging methodology statements we will consider two charging principles:

- the resulting tariffs must be justified by reference to the costs of the distribution network, and
- costs must be allocated to individual network users on an objective, justifiable and non-discriminatory basis.

2.5. In the December 2010 consultation we consulted on three charging principles. However we concluded that the principle requiring that 'the final tariff must be not

favour one user over another' was not appropriate, since under the Regulations we are not required to approve the final tariffs for TPA. We approve the methodology underlying the tariffs rather than the tariffs themselves. However to address the issue of discrimination underlying this principle we have instead inserted the requirement not to discriminate into the second principle.

2.6. The main purpose of network charges is to recover the costs of maintaining and operating the distribution network. Therefore the key principle underpinning any charges should be that they reflect these costs.

2.7. Typically a network will have more than one customer and therefore the network costs will need to be shared between all customers. The principles require that network costs are allocated fairly and objectively in a reasonable manner across all customers. This will include customers who use third party suppliers and other customers, including those using a supplier affiliated with the ENO.

Guidance on the completion of the charging methodology statements

2.8. In our consultation we said that the aim of our guidance was to assist ENOs in developing charging methodologies in a way that fitted the needs of their businesses. We also wanted to make the process of developing charges to minimise the burden placed on the ENOs, recognising that, for the most part, the distribution of energy would not be the main focus of their businesses.

2.9. We propose that ENOs can use a pro forma of a charging methodology statement setting out annual charges, which the Authority can approve if all the relevant information has been included.

2.10. The pro forma and guidance in chapter 3 are intended to help ENOs put together their charging methodologies while minimising the burden on them. For the purposes of clarification we are not placing a requirement for ENOs to complete the use of system charging methodology pro forma. For example for a small ENO with one or two small customers we would not necessarily expect them to provide the level of detail contained in our pro forma. A submission is likely to be acceptable if it:

- provides a reasonable and proportionate method of identifying costs,
- complies with the charging principles set out above,
- has been substantiated with supporting data, recognising that there may be issues associated with data availability and there are circumstances where estimates may need to be made
- provides an explanation of how the costs have been allocated between network users, and
- allows parties to understand the basis on which their charges have been calculated.

Guidance on use of system charging methodology statements for larger ENOs

2.11. In addition to the information set out in the pro forma, larger ENOs should also consider providing the following information in the charging methodology statement:

- detailed information to substantiate network costs that will be recovered through use of system charges, particularly where costs have been apportioned,
- whether these costs will be recovered through ongoing or one-off use of system charges,
- an assessment of the types of customers connected to their network and how they are likely to affect the allocation of charges,
- what the charges are for different categories of customers preferably with examples of different customers and how their charges would be calculated,
- a long term assessment of how charges are likely to change and how they will affect different types of customers,
- a justification of why the charges that will result from the application of the methodology will satisfy the charging principles.

2.12. Once we have had the experience of approving the charging methodology statements and can appropriately define what we consider to be a large ENO we will consider updating the guidance to provide this definition and clarify the additional information we require from large ENOs.

Further guidance

2.13. We reiterate that there is no pre-defined single structure for use of system charges. We recognise that a wide variety of circumstances could apply to ENOs. Some larger ENOs may already have a set of charges in place and may wish to use this for their use of system charges.

2.14. Other ENOs may have a very different contractual relationship with parties connected to their networks. One common example is likely to be where the ENO has a long term rental or leasing agreement with the customer. In these circumstances there may, for example, be no separate energy charge with the rental charges being on a pound per square metre basis. Again it may be appropriate for the ENO to use this tariff structure to bill its ongoing use of system charges.

2.15. The key points for ENOs are that the use of system charge is separately identified, that they should take reasonable and proportionate steps to ensure their charges comply with the principles outlined in paragraph 2.4 above and that they should provide substantiating information on the method they have used.

Identifying network costs

2.16. The charging methodologies should only seek to recover costs associated with energy distribution activities. Our powers under the legislation only allow us to approve methodologies for calculating energy distribution charges. Therefore, we will not be able to approve methodologies submitted to us which include costs not related to energy distribution in the calculation of use of system charges. Below we set out some examples of costs that can and cannot be recovered through an approved use of system charging methodology.

Losses on bulk purchase agreements or "take or pay" energy supply contracts

2.17. Where ENOs are also suppliers of energy to customers connected to the network they often purchase the energy in bulk and then sell the energy on to their customers. The bulk purchase contracts typically include a requirement to purchase a minimum amount of energy, and such contracts are also known as take or pay contracts.

2.18. Where customers choose to switch suppliers an ENO could face potential losses for example where an ENO is required to purchase a certain amount of energy, but because one or more customers has switched suppliers, the ENO is unable to sell all of this energy to customers connected to its networks.

2.19. Our view is that any losses on supply contracts resulting from customers switching cannot legitimately be recovered through approved distribution use of system charges. We take this view because these are related to supply rather than distribution activities and the Directives, and the legislation, make a clear distinction between these.

2.20. We note that in their draft guidance document, DECC[19] provide further guidance on the treatment of bulk purchase agreements.

Costs related to distributed generation

2.21. Some ENOs also supply energy to customers connected to their networks through decentralised ("distributed") generation assets they also own and operate. By changing suppliers the ENO is no longer able to recover the capital and operating costs of these generation activities from their customers although they invested in these assets on the basis that they would be able to do so.

2.22. Our view is that costs associated with power generation cannot legitimately be recovered through approved distribution use of system charges. We take this view because these costs are related to generation/supply activities of rather than the energy distribution.

[19] DECC Draft Guidance: Provision of third party access to licence exempt electricity and gas networks, 14 October 2011.

Carbon reduction commitment (CRC) costs

2.23. Where a customer chooses to switch to an alternative supplier, in some instances ENOs who are also suppliers would still be liable for carbon credits purchased in respect of that customer's energy use. Under the CRC scheme energy suppliers have to purchase carbon credits for the energy they supply. Further, the scheme requires that they purchase the credits ahead of supplying the energy. Suppliers therefore have to forecast the amount of energy they expect to supply each year and purchase carbon credits based on the forecast. If an ENO/supplier purchases credits based on a forecast that assumes a certain level of consumption from its customers and then one or more of these customers switch, they will still have to purchase the credits.

2.24. However our view is that the costs of these credits cannot be recovered through use of system charges because they relate to supply rather than distribution activities.

Costs of providing TPA

2.25. We consider that any associated costs of providing TPA such as any costs associated with metering and billing services could be recovered through use of system charges. For example, the costs associated with obtaining metering information from a third party supplier in order to derive supply data from the rest of the ENO's customers could be recovered.

3. Guidance on completing the pro forma

Chapter Summary

This chapter sets out guidance on how ENOs can complete the use of system charging methodology pro forma should they choose to do so.

Completing the use of system charging methodology pro forma

3.1. We have considered the appropriate level of information that we will need from ENOs in order to approve their charging methodologies. Appendix 1 sets out an example of a pro forma of a use of system charging methodology. We have also included the excel spreadsheet we used to calculate the costs in Appendix 2.

3.2. The pro forma provides an illustrative example of how the ENO can submit the information. If there is further information the ENO considers is relevant to its submission then ENOs are welcome to amend the pro forma document. However, it would be helpful for us to understand why the pro forma has been amended.

3.3. Wherever possible we would also require information to substantiate the information provided in the pro forma. Failure to provide this information could lead to delays to the approval of the methodology.

3.4. The pro forma is designed to help to identify the kind of information we would expect to see when approving a charging methodology. However, other approaches will be acceptable.

Definition of terms used in the pro forma

3.5. The pro forma contains a number of terms which are defined below.

- **Current value of the network asset** – This is the current book value of the network asset.
- **Direct operating costs** - Direct costs are the operating costs that can be directly attributed to the distribution network. In our example we include labour costs, materials, network maintenance costs and network repair costs.
- **Indirect operating costs** - Indirect costs are operating costs that cannot be directly attributed to the distribution network specifically. In our example, we include IT and telecoms costs, audit and finance costs and insurance.
- **Total operating costs** – Operating costs are the summation of direct and indirect operating costs.
- **One-off upfront costs** - These are costs which the ENO has incurred in order to facilitate third party supply for its customer. We do not envisage that this will include connection or network upgrade costs as these costs are unlikely to be recovered upfront. In our example we include the costs of agreeing a contract with the third party supplier for enabling access to the network and the cost of connecting the supplier's meter to the distribution network.

- **Opening asset value -** The opening asset value is the book value of the network asset at the start of the year.
- **Closing asset value –** The closing asset value is the opening asset value minus depreciation over the year.
- **Cost of capital –** This is the rate of return the network operator expects to receive from providing the network asset and services.
- **Depreciation -** Depreciation is calculated as the current book value of the asset divided by the number of years that the ENO has decided to depreciate the remaining book value of the asset over.
- **Tax** – Taxation costs to be recovered from network users (for the excel spreadsheet example taxation costs are set to zero).

Sections 1 and 2 of the pro forma

3.6. Section 1 of the pro forma provides us with information to understand the nature of the ENO's business and distribution activities, as well as contact information.

3.7. Section 2 of the pro forma enables the ENO to confirm that they have met the requirements of the charging principles when setting out the methodology and provide an explanation of how they have met the principles. For clarification we will make our own assessment of whether the ENOs are meeting the charging principle obligations based on all the information they provide in their submission

Section 3 of the pro forma: Deriving network charges

3.8. We have calculated total annual costs as annual asset costs plus direct costs plus indirect costs plus taxation costs. In addition, we envisage that ENOs will incur one off upfront costs.

Annual asset costs

3.9. In the example given we have used a notional cost of capital and asset life to determine the depreciation value. We appreciate that the cost of capital is likely to be different for different ENOs so we would expect this figure to be substantiated with supporting evidence.

3.10. We will also require information to substantiate the ENO's assessment of the current book value of the network asset. We appreciate that in some instances it may not be possible to calculate the total network book value, for example where gas pipes, electric wires and telecom wires were laid together at the same time. If so, then some apportionment of cost would be acceptable as long as it is accompanied by an explanation of how these costs have been apportioned and an assurance that appropriate and proportionate steps have been taken to identify the value of the distribution assets in question.

3.11. Some ENOs may have to estimate the value of their asset, particularly where the assets are very old. In this case it would be acceptable to populate the pro forma with estimated figures as long as the ENO can sufficiently explain, for example in section 6 of the pro forma, why it was not possible to include actual costs.

Direct and indirect costs

3.12. As with asset costs some apportionment of direct and indirect costs is likely to be necessary therefore as set out in paragraph 3.10 we would need an explanation of how these costs have been apportioned.

3.13. In the pro forma we have assumed that direct and indirect costs will be remunerated through the use of system charge in that year. However, it may be the case these costs have been financed and are payable over a number of years in which case please annotate the pro forma as appropriate.

3.14. In the excel spreadsheet we have assumed that the only factor to affect operating costs is inflation. Where operating costs change over time for other factors, for example where staff numbers increase because the number of customers increase, we would require an explanation to substantiate the change in costs.

Taxation

3.15. ENOs may also want to include taxation costs arising from the operation of the distribution system in the total costs of the network. As with indirect costs we would need an explanation of how these costs have been apportioned to the distribution business. For simplicity, our excel spreadsheet assumes taxation costs are zero. If ENOs wish to use the spreadsheet they will need to populate the relevant cells for tax.

One-off upfront costs

3.16. It will be for the ENO to determine whether these costs are recovered through the use of system charge, which may lead to much higher charges in the first year or whether to bill these costs separately and also whether they wish to capitalise the costs.

3.17. In our example we have assumed that one-off costs will not be recovered through use of system charges. However we consider that they should still be identified in the use of system charging methodology statement and have included it in the pro forma.

Section 4 of the pro forma: Allocation of total annual costs

3.18. This information is key to customers understanding how their costs have been derived. In our example we have taken total annual costs and divided it by the number of customers on the network to calculate the annual charge. Other approaches could allocate costs based on energy consumption, rental space etc.

3.19. The ENO will need to consider the different characteristics of their customers and apportion costs accordingly. For example if one customer has very volatile demand that requires network investment to ensure that its peak demand is met they may incur a higher distribution charge than a customer with low and stable demand. Also, if one customer is much larger than another customer and consumes significantly more energy it may not be appropriate for them to face similar charges.

3.20. The pro forma should include an explanation of why the method of allocation charges to customers was chosen.

Section 5 of the pro forma: Issues that are likely to affect future charges

3.21. Although the use of system charging methodology does not include charges and the Authority is not responsible for approving an ENO's charges, we consider that parties should be able to understand the basis on which the charges have been calculated by looking at the methodology. Therefore, if the ENO envisages future investment that is likely to affect charges, we would expect the ENO to set out the details of the investment and how it is likely to affect charges.

3.22. In the example shown in the excel spreadsheet and pro forma we illustrate how capital expenditure of £5m impacts on annual asset costs and consequently network charge.

3.23. For clarification we do not expect ENOs to re-submit their use of system charging methodology statements to us if they undertake investment in the future which changes their charges, unless it results in a change to the methodology for calculating and/or allocating the charges.

3.24. In the use of system charging methodology statement we expect ENOs to provide information on how often they envisage their charges to change, how they intend to notify their customers of a change to charges and how much notice they will give their customers before the change to charges takes effect.

Section 6 of the pro forma: Any other relevant information

3.25. This section provides ENOs with the opportunity to include any other information that might be relevant to their submission. As set out in paragraph 3.11 if ENOs have provided estimated asset costs they can use this section to explain why they were unable to use actual costs.

The illustrative excel spreadsheet

Cell colours

3.26. The yellow cells are input cells. The green cells have automatic calculations in them and the orange cells are for data that is determined externally, ie in this case the inflation forecast value would need to be completed by based on actual forecast data.

Explanation of the illustrative excel spreadsheet

3.27. In our example the network charge has been set to recover annual network asset costs and operating costs (ie direct plus indirect costs) taking into account an assumed inflation of three per cent and the depreciating value of the network asset divided by 200 customers. The annual return on the network asset is calculated as the average of the opening and closing network asset value multiplied by the cost of capital.

3.28. In our example we also show how capital expenditure of £5m undertaken in 2014 affects total costs of running the network and therefore how network charge increases to take account of these costs.

3.29. An input for taxation costs is provided in the excel spreadsheet but for the purposes of the example is set equal to zero.

4. Connection to Licence Exempt Distribution Networks

Chapter Summary

In this chapter we outline our guidance on connection issues and provide some clarification on what could constitute connection costs.

Introduction

4.1. This chapter is intended to provide ENOs and other parties with the factors we would consider if we are asked to determine on a connection charge. This section includes a summary of the legislative requirements and the types of connection costs that could be incurred when making a connection to the network. As connections tend to be bespoke we have not commented on what constitutes reasonable costs but will review the costs on a case by case basis.

4.2. As we have no experience of determining connection disputes relating to ENOs we have not explained how we will determine a connection dispute. Once we have had some experience of this we can update the guidance document.

Legislative requirements

4.3. The duty to connect a third party supplier only applies where:

- the party wanting to connect can provide evidence that at least one third party supplier is willing to supply them with energy, and
- the exempt network operator has not demonstrated that it is entitled to refuse access on the basis of lack of capacity as provided for in the legislation[20] [21].

However, the ENO will not be required to make a connection if:

a) the ENO is prevented from providing a connection by circumstances outside its control;
b) the connection would or might involve danger to the public and the ENO has taken all reasonable steps to prevent such risk of danger; or

[20] Paragraph 1(5) of new schedule 2AA of the Gas Act and new schedule 2ZA of the Electricity Act.
[21] The lack of capacity provisions only apply where the exempt network operators need to increase the capacity of their network to provide third party access and they can justify not providing additional capacity against the criteria outlined in paragraph 1(5) of the draft legislation.

c) it is not reasonable in all circumstances for a connection to be provided[22].

4.4. In the event that an exempt network demonstrates that it is entitled to refuse access on the ground of lack of capacity or that it meets the circumstances that prevent it from providing a connection, the third party supplier can request that Ofgem make a determination on the dispute under the Gas or Electricity Act[23].

Connection charges

4.5. The legislation allows licence exempt network operators to recover any expenses reasonably incurred in making a connection to its network. Connection costs are usually considered to be the incremental cost of connecting a customer or supplier to a network. Connection to the network tends to be bespoke and therefore we are not able to provide guidance on what constitutes a reasonable charge for connection in this guidance document. Reasonable expenses can only be judged on the circumstances of each case and the complexity of the connection required. However, below we set out the types of costs that are likely to be associated with a connection. This is not intended to be an exhaustive list but illustrative of connection costs that a licence exempt network may face. These costs can include:

- budget estimates
- procurement costs
- assessment and design costs
- material costs
- land rights negotiations
- excavation costs
- cabling/pipeline costs
- jointing to the network
- inspection and testing.

Budget estimate

4.6. This could be a high level initial assessment of the costs of a connection without the detail of an assessment and design to give the third party supplier/ customer an initial idea of costs before a decision is made to go ahead with the connection.

Procurement costs

4.7. In the event that an ENO procures the services of a third party to undertake the connection work on its behalf it can recover the costs from the third party supplier.

Assessment and design costs

[22] Paragraph 8(6) of new schedule 2AA of the Gas Act and new schedule 2ZA of the Electricity Act.
[23] Under paragraph 3(9)(a) of the legislation.

4.8. This is likely to be a detailed assessment of the appropriate location of connection, setting out the design of the connection and costing of assets required for the connection. We would envisage that the assessment and design will determine the full cost of the connection and would form part of the connection contract. The assessment and design costs are likely to identify and quantify some of the costs below.

Material costs

4.9. These are the costs of all the materials involved in making the connection, other than cabling/pipeline costs.

Land rights negotiations

4.10. If the connection runs through land owned by a third party there are likely to be costs associated with negotiating the rights to access the land either for excavating the land to install pipelines, cabling or overhead lines.

Excavation/Construction costs

4.11. Costs of excavating to lay down pipelines or construction for the cables for the connection.

Cabling/pipeline costs

4.12. The costs of procuring cabling/pipeline for the connection. This cost could be included in material costs.

Jointing to the network

4.13. Once the connection work is complete this involves the costs of physically connecting the connection to the existing network.

Inspection and testing

4.14. Ensuring that energy is flowing safely prior to finally commissioning the connection.

5. Process for approval of methodologies

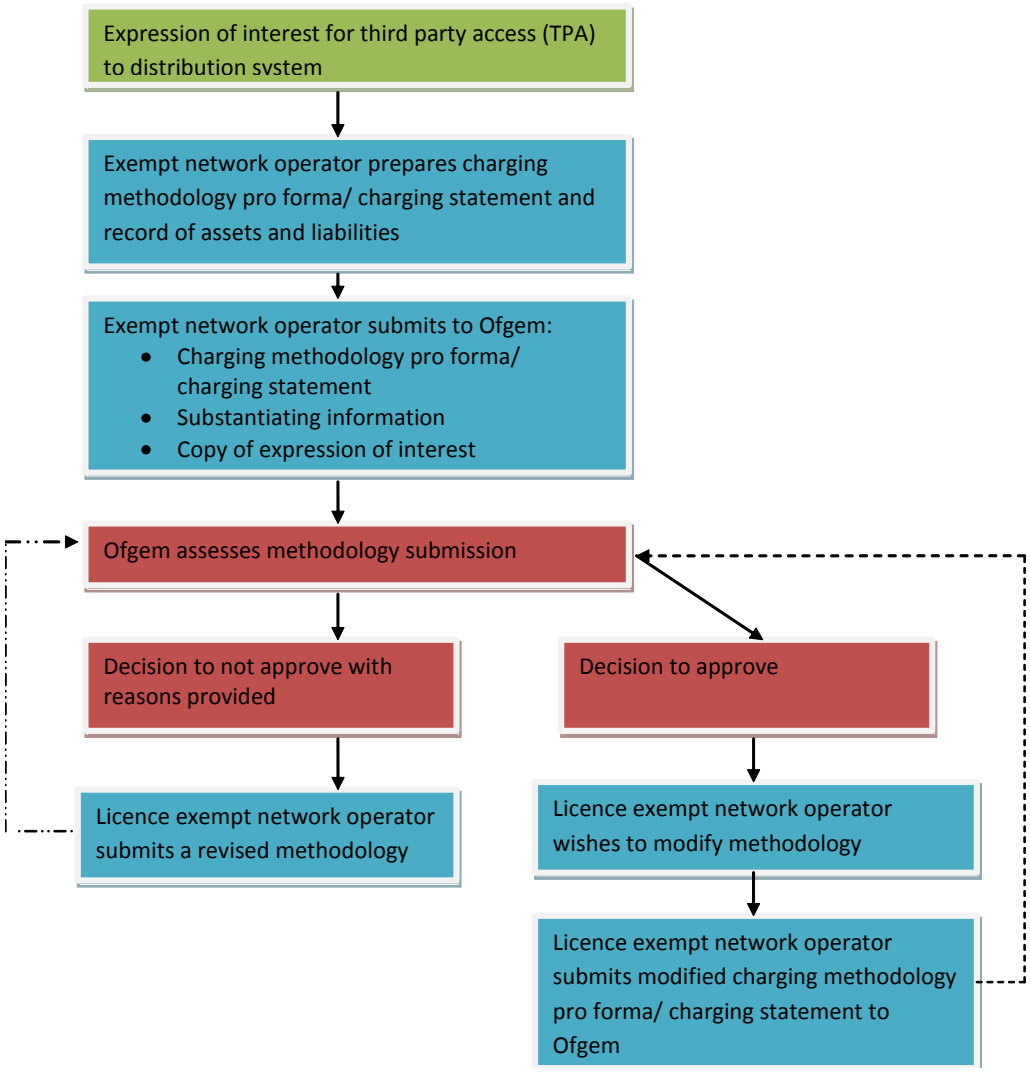
Chapter Summary

This chapter sets out the process by which we intend to approve use of system charging methodologies.

Overview

5.1. In our consultation document we outlined how we thought the process for approving UoS charging methodologies would work. With the publication of the legislation we can now set out in more detail the process of approval we will follow. We provide an overview of the process we intend to follow in figure 5.1 below.

Figure 5.1: Overview of methodology approvals process



5.2. ENOs are only required to bring forward a methodology for approval where they have received an expression of interest from those connected to or seeking a

connection to their network, and where they intend to make a separate use of system charge for it.

5.3. Under the draft legislation, Ofgem should make a decision on approval of charging methodologies as soon as is reasonably practicable. It is difficult to commit to a generic timeframe for approving methodologies since the level of work will depend on the quality of the submissions and the time it takes to get any additional information from the ENO that we need to make a determination. We are also mindful that we could receive a large influx of requests as a result of the legislation coming into force, and envisage that it will take longer to approve the first few methodologies we receive as we embed our internal approval processes.

5.4. Our view is that in due course we will be able to update our guidance and pro forma. We will also be able to provide additional information to ENOs to simplify and streamline the process as much as possible. For now we will endeavour to approve a methodology within one month of receiving the submission.

5.5. Once we have approved or decided not to approve the charging methodology statement we will publish our decision letter on the Ofgem website. We do not intend to publish the ENO's charging methodology statement.

Appendices

Index

Appendix 1 – Use of System Charging Methodology Statement pro forma

1.1. Set out below is the pro forma for approving charging methodologies for third party access to licence exempt Distribution Networks (ENOs).

1.2. The pro forma has been completed to give an indication of the information we would be expecting to see from ENOs. The example charging methodology is intended to help a customer of the network understand how their use of system charge has been derived.

1.3. A blank pro forma is provided as an attachment to this document.

Methodology for use of system

Section 1: Information about the ENO

Name of business:

Address of business:

Contact name:

Email address and phone number:

Description of the main activity of the business:

Number of customers connected to the network:

Total annual energy consumption of all customers connected to the network for the last full calendar year:

Geographic size of network:

Brief description of the main activity of the customers connected to the network:

Section 2: Confirmation that you have conformed to the two charging principles

Please confirm that your charges:		**Tick box**
Are justified by reference to the costs of your distribution network		✓
Have been allocated to individual network users on an objective, justifiable and non-discriminatory basis		✓
Please explain how you have conformed to the two charging principles (referring to subsequent sections of this methodology if required):		
Use of system charges are calculated as operating costs plus depreciation plus a return on the average asset base in any year. Use of system charges relate only to the cost of our distribution network. Each customer takes an equal share of the charge. This is appropriate because each customer makes use of the distribution network in any year and customers have similar energy consumption, capacity requirements and profile of demand usage on the network.		

Section 3: Explanation of how you have derived your costs (Illustrative, for guidance only)

Type of cost		***Cost (£)***
Distribution Network Cost (explain how the cost was derived)		
Total value of network asset		£10m
Cost of capital		8.5%
Asset life (remaining years the asset will be depreciated over)		25
Annual Capital Cost (approximately)		*£1.2m*
Annual Direct Costs		
Labour costs		£0.25m
Materials		£0.25m
Network maintenance		£0.25m
Network Repair		£0.25m
Total Annual Direct Costs		*£1m*
Annual Indirect Costs		
IT and telecoms		£0.2m
Finance and Audit		£0.5m
Insurance		£0.3m
Total Annual Indirect Costs		*£1m*
Tax		**[£0m]**
One off upfront costs		
Contract costs		£0.01m
Connecting supplier's meter to distribution network		£0.02m
Total Annual costs = Annual asset costs + direct costs + indirect costs + taxation costs		**£3.2m**
Please confirm that these costs only include network costs		✓

Section 4: Explanation of how you have allocated your total annual charges

Detail how you intend to allocate the total distribution costs to your customers (e.g. divide the costs by number of customers, square metre of rental space, annual consumption of energy)

There are 200 customers connected to the distribution network who have similar energy consumption so we would calculate the charge for each customer as 3.2/200 of the total annual distribution cost i.e. approximately £16,165 per annum. (*Numbers are illustrative*)

Section 5: Issues that are likely to affect future charges

Details of any future investment that is likely to affect your charges

In 2013/14 we intend to reinforce the network. The estimated cost of this investment is £5m. This will increase our annual distribution costs and will result in an increased annual distribution charge to individual customers.

How often do you envisage distribution network charges will change?

We intend to review our charges every year to ensure that costs recovered from customers are broadly in line with our distribution network costs taking into account inflation, the depreciating value of the network asset and the cost of our annual direct and indirect costs.

How do you intend to notify customers of a change to charges and how much notice of a change to charges will you provide?

We intend to provide our customers with 3 months' notice of a change to charges and will notify them in writing. They will also be able to find the charging methodology statement on our website.

Section 6: Any other relevant information

n/a

Signed by ……

On behalf of (company name) ……..

Date ……..

Appendix 2 – Illustrative excel spreadsheet associated with the use of system charging methodology pro forma

	Unit										
Beginning of FY	Year		2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Last 2 digits of year	-		12	13	14	15	16	17	18	19	20	21
Financial Year	FY		2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Period			1	2	3	4	5	6	7	8	9	10
Key												
		Input to be set by network operator										
		Input set by network operator from external data										
		Calculation										
Inputs												
Inflation	%		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
First year of charging methodology		2012										
Cost of capital (real)	%	8.5%										
Annual direct costs	£m	1										
Annual indirect costs	£m	1										
Tax	£m											
Existing network asset												
Value of network asset at purchase	£m	10										
Year of purchase	Year	1992										
Remaining life of asset in first year of charging methodology	Years	20										
Cumulative Inflation Index relative to purchase date	Index	57										
Capital expenditure												
Capital expenditure	£m	5										
Financial year new asset becomes operational	Year	2014										
Years of depreciation (asset life) of capital expenditure	Years	40										
Number of customers	[ ]		200	200	200	200	200	200	200	200	200	200

Note: example shows total costs allocated by no. of customers - other options such as energy consumption, rental space, use of capacity etc. could also be adopted.

	Unit										
Beginning of FY	Year		2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Last 2 digits of year	-		12	13	14	15	16	17	18	19	20	21
Financial Year	FY		2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Period			1	2	3	4	5	6	7	8	9	10
Calculations												
Inflation	%		103.0%	103.0%	103.0%	103.0%	103.0%	103.0%	103.0%	103.0%	103.0%	103.0%
Operating costs												
Annual direct and indirect operating costs	£m		2	2.1	2.1	2.2	2.3	2.3	2.4	2.5	2.5	2.6
Annual asset cost of existing asset												
Present day value of asset purchase cost	£m	17.7										
Implied total asset life of existing asset	Years	40										
Implied current value of existing asset	£m	8.8										
Opening asset value	£m		8.8	8.4	7.9	7.5	7.1	6.6	6.2	5.7	5.3	4.9
Depreciation	£m		0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Closing asset value	£m		8.4	7.9	7.5	7.1	6.6	6.2	5.7	5.3	4.9	4.4
Average network asset value	£m		8.6	8.2	7.7	7.3	6.8	6.4	6.0	5.5	5.1	4.6
Return on network assets	£m		0.7	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.4	0.4
Total annual asset cost (existing asset)	£m		1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.1	1.1
Annual asset cost of new assets												
Opening asset value	£m				5.0	4.9	4.8	4.6	4.5	4.4	4.3	4.1
Depreciation	£m				0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Closing asset value	£m				4.9	4.8	4.6	4.5	4.4	4.3	4.1	4.0
Average network asset value	£m				4.9	4.8	4.7	4.6	4.4	4.3	4.2	4.1
Return on network assets	£m				0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Total annual asset cost (new asset)	£m				0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Total annual asset cost												
Annual asset cost	£m		1.2	1.2	1.7	1.8	1.8	1.8	1.7	1.7	1.7	1.7
Tax												
Annual tax	£m		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total costs												
Total annual network cost	£m		3.2	3.3	3.9	3.9	4.0	4.1	4.1	4.2	4.3	4.3
Network charge												
[in example this is £s per customer]	£s		15,864	16,322	19,330	19,727	20,043	20,361	20,679	20,999	21,318	21,639

Appendix 3 - Summary of responses

1.4. In our December 2010 consultation document[24] we sought the views of respondents about a number of questions. In this section, we provide a summary of their responses.

CHAPTER: Three
Question 1: Do you have any views on the proposed principles that will underpin ENOs' network charges?

Question 2: Is the common methodology we have proposed proportionate? Is further guidance required on particular issues?

1.5. Respondents were in general supportive of the proposed principles and welcomed our view that the process for developing charges should place as little burden on the ENOs as possible, recognising that for the most part the distribution of energy would not be the main aspect of their businesses. However, a number of them suggested that various aspects of the guidance that we set out were too prescriptive. One example that was given was the indicative cost of capital that we provided for energy distribution businesses.

1.6. We consider that there has been a misunderstanding and would like to emphasise that any guidance that we provided in the consultation was not meant to be prescriptive but rather indicative of what we might expect from a use of system charging methodology.

1.7. Our view is that any reasonable and proportionate method for identifying the costs of the energy distribution activities' in accordance with the charging principles, with information for customers to explain how their charges have been derived would constitute an acceptable methodology for small ENOs. We would expect greater detail from a larger ENO as stated in chapter 2 of this guidance.

1.8. A number of respondents to our consultation suggested that more clarity was needed regarding what constitutes energy distribution costs and in particular what costs can be recovered though approved use of system (UoS) charges. The respondents gave a few specific examples of types of costs where they would like clarity as set out below.

1.9. Some respondents who are ENOs and licence exempt suppliers suggested that where customers choose to switch suppliers under the new Regulations they would face potential financial losses. This is because they have purchased the energy in

[24] Guidance on third party access charges for licence exempt gas and electricity distribution networks, 20 December 2010 (ref:166/10).

bulk on behalf of their customers with a requirement to purchase a minimum amount of energy on a take or pay basis.

1.10. As stated in chapter 2 of this document, we consider that any losses from supply contracts cannot be legitimately recovered through the use of system charge as the charges must relate to distribution charges.

1.11. We received two responses from ENOs who also supply energy to customers connected to their networks through decentralised ("distributed") generators they also own and operate. These respondents suggested that they should be able to recover the capital and operating costs of these assets through use of system charges. The respondents pointed out that it is important for their businesses that they are able to recover these costs from the network customers as they had invested in these assets on the basis that they would be able to do so.

1.12. Our view is that costs associated with power generation cannot legitimately be recovered through approved distribution use of system charges because these costs are related to generation and/or supply activities rather than energy distribution.

1.13. Several respondents noted that where a customer chooses to switch to an alternative supplier, then ENOs who are also suppliers would still be liable for carbon credits purchased in respect of that customer's energy use. Under the CRC scheme energy suppliers have to purchase carbon credits for the energy they supply. Further the scheme requires that they purchase the credits ahead of supplying the energy. Suppliers therefore have to forecast the amount of energy they expect to supply each year and purchase carbon credits based on the forecast. If an exempt network/supplier purchases credits based on a forecast that assumes a certain level of consumption from its customers and then one or more of these customers switch, they will still have to purchase the credits. Some respondents suggested that the costs of these credits should be able to be recovered through use of system charges.

1.14. Our view is that CRC costs cannot legitimately be recovered through approved distribution use of system charges because they are related to supply rather than distribution activities.

1.15. Some respondents suggested that it was unclear from our consultation whether certain costs of providing TPA such as costs of metering and billing services could be recovered though use of system charges. Our view, as stated in chapter 2 of this document, is that any associated costs of providing TPA such as any costs associated with metering and billing services could be recovered though use of system charges. For example, the costs associated with obtaining metering information from a third party supplier in order to derive supply data from the rest of the ENO's customers could be recovered.

CHAPTER: Five

Question 1: Is our proposed approach appropriate? Are there other arrangements which could be put in place and would help the sector comply with its obligations?

1.16. Some consultation responses suggested that we should commit to a specific timeframe for approving methodologies. In chapter 5 of this document we set out our aim to approve the methodologies within one month of receiving the application

although we consider that the volume and quality of the submissions may prevent us from meeting this timescale.

Other issues

1.17. A number of respondents to the consultation suggested that the extent of the duty to connect in general and the lack of capacity provisions were unclear and that our discussion of these was limited. The discussion in our consultation was brief in part because the focus of the consultation was to provide guidance on charging and in part because the draft legislation was not finalised at the time of its publication. However we have provided an explanation of the lack of capacity and connections obligations in the draft legislation in chapter 1 of this document.

1.18. In the responses to our consultation some respondents suggested that our guidance on the costs that can be recovered through connection changes was a little unclear. In particular some respondents queried whether the incremental costs of providing TPA could be recovered. Some respondents also indicated the distinction between what should constitute UoS and connection charges could benefit from further clarification.

1.19. We are unable to offer much detailed guidance on the reasonable expenses that could be recovered though the connection charges. This is because each connection to a network can be very different and reasonable expenses must be judged on the circumstances of each case. We have provided some guidance in chapter 4 on the types of connection charges that the ENO may charge for.

1.20. A number of respondents to our consultation raised questions on aspects of the Governments' proposed implementation of TPA for licence exempt networks. One of the most prominent issues was regarding the timetable for implementation of the Third Directives. In addition, many respondents questioned the need for the implementation of TPA in the form proposed. They considered that many customers connected to exempt networks already benefited from the competitive market though competitive tendering of for supply of their bundled energy requirement by the exempt notary operator or an associated exempt supply concern.

1.21. We are unable to respond directly to these concerns as these issues are beyond the scope of Ofgem's remit.

Appendix 4 – Glossary of terms

A

Asset life

The life of distribution assets can be defined with regard to the technical life of the asset or the economic life ("usefulness") of the asset.

C

Capital expenditure (capex)

Expenditure on investment in long-lived distribution assets, such as underground cables and pipes.

Connection charges

Charges paid by generators and demand customers for connection to the distribution network.

Court of Justice of the European Union

The Court of Justice of the European Union (often referred to simply as 'CJEU' or 'the Court') was set up under the Treaty on the Functioning of the European Union following the Lisbon Treaty. Previously known as the Court of Justice of the European Communities (or 'European Court of Justice'), its principal role is to make sure that EU legislation is interpreted and applied in the same way in all EU countries.

D

Department of Energy and Climate Change

DECC is the Government department responsible for energy policy and climate change policy in Great Britain.

Depreciation

Expense associated with spreading (allocating) the cost of an asset over its useful life.

E

ENOs

Exempt distribution network operators.

Expense

Cost from operations. The opposite of revenues.

G

Gas and Electricity Markets Authority (GEMA)

GEMA (or the 'Authority') is the governing authority of Ofgem. The Authority's powers are provided for under the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998 and the Enterprise Act 2002.

L

Licensable activities

The Gas Act 1986 (as amended) and The Electricity Act 1989 (as amended) (the Acts) prohibit certain activities unless the person carrying on that activity is licensed, exempt from the requirement for a licence, or eligible (under the Gas Act only) for an exception to the prohibition on unlicensed activities.

N

Net Book Value

The asset's cost minus accumulated depreciation.

National regulatory authority

Ofgem is the national regulatory authority for the energy sector in Great Britain.

O

Operating expenditure (opex)

Fixed and variable costs associated with the provision of the service (such as access to the distribution network).

R

Retail Prices Index (RPI)

The Retail Prices Index (RPI) is the most familiar general purpose domestic measure of inflation in the United Kingdom. It is available continuously from June 1947.

T

Third party access

Third party access policies require owners of monopoly infrastructure facilities to grant access to those facilities to parties other than their own customers, including other suppliers.

U

Use of System Charges

Charges paid by generators and demand customers, usually via suppliers, for the use of the distribution network.

W

Weighted Average Cost of Capital (WACC)

This is the weighted average of the expected cost of equity and the expected cost of debt.

Appendix 5 - Feedback questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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