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21 March 2003

Dear Colleague,

DISTRIBUTION PRICE CONTROL REVIEW - BUSINESS PLAN QUESTIONNAIRE RELATING TO DISTRIBUTED GENERATION

Introduction

An important task for the forthcoming review of the distribution price control is to develop appropriate incentives for the distribution network operators (DNOs) to connect and provide network access to distributed generation (DG). Mainly as part of this task, but also as a part of the process of determining the DNOs' capital and operational expenditure allowances, Ofgem needs to collect from the DNOs information pertinent to their recent activities and future business plans in relation to DG. Ofgem's objectives in collecting such information are:

- to establish a consistent set of information on the past performance of DG-related distribution activities;
- to understand the drivers for the cost impact of DG on the distribution companies; and
- to obtain projections relating to the future potential development of DG and the likely impact on the investment, operation and the efficient level of costs of each of the distribution networks.

This is the first time that detailed data relating to DG has been required for a distribution price control review. Ofgem and the DNOs need to work together to consider carefully what information should be gathered from the companies to meet the above objectives. Once the format of information to be collected is established, the companies will need to compile the required information. Given the significance of this area of work, especially in terms of the effort required from both Ofgem and the companies, we intend to treat the establishment of, and the data collection under, the Business Plan Questionnaire (BPQ) in relation to DG (referred in the rest of this letter as the DG-BPQ) as a separate work stream to proceed in parallel with work on other areas of the distribution price control BPQ.

The aims of this letter are:

- to share with you our initial thoughts on the structure and content of the DG-BPQ;
- to invite your comments on the:
 - general structure of the DG-BPQ;
 - appropriateness of the areas of information identified;
 - availability and quality of information in your company for the areas identified;
 - identification of other areas of information that you believe should be added; and
- to request initial high level input from you in a few key areas which will help the development of the DG-BPQ.

Structure of the DG-BPQ

We envisage that the DG-BPQ will consist of four sections: historical, interim period forecast, future baseline, and future incremental. The data items we intend to collect are shown in the initial draft tables attached to this letter.

1. Historical DG Information

This section will cover all DG projects whose full commissioning took place between 1 April 2000 and 31 March 2003. In the context of DG-BPQ, “full commissioning” means that all required work on the distribution network has been completed so that the network is capable of accepting full output from the generator.

The first part of this section of the DG-BPQ will include reasonably detailed data items for each DG project, as shown in the attached Table 1.1. The main areas of information required are the nature of the DG plant, the work and costs required for the DNO to connect and provide network access to the DG plant, and the operational and contractual arrangements between the DNO and the DG. For the purpose of specifying the types of DG, we propose to adopt the same categorisation used in a recent survey carried out by the Technical Steering Group under the joint DTI/Ofgem Distribution Generation Coordination Group. A reference table (Table R1) is included before Table 1.1 for your information.

For DG projects impacting on infrastructure assets shared with other users of the network, further details will be required on relevant work and costs. These are set out in Table 1.2. The distinction shown between 'sole-use' and 'shared' assets is illustrative – it is envisaged that initial proposals from Ofgem's structure of charges project will be published in the next few weeks and we expect to use the connection charging boundary included in those proposals to derive the split between Tables 1.1 and 1.2 and the subsequent relevant tables.

As the level of DG increases, it is expected that the DNOs will incur strategic capital and operational expenditure, for example on research and development, in preparing their networks to accommodate increased DG as well as in beginning to move their function from passive one-way distribution to actively managed flexible transportation of electricity and the provision of other relevant services. As these costs are not normally attributed to any individual DG project, a separate Table 1.3 will be used for DNOs to report the relevant information. It may be helpful to group the costs entered in this table under standard headings. We welcome your views on the appropriate cost categorisation to be adopted for this purpose. Table 1.3 will also include the original projection in the BPQ at last price control review for DG related costs and the total outturn for the period between 1 April 2000 and 31 March 2003.

If only a very small number of DG projects are captured within the three-year time window, consideration may be given to using an earlier start date for this section, eg to include the previous price control period from 1 April 1995 to 31 March 2000.

In order to make a decision on the timeframe, and potentially to adjust the level of detail, of the historical DG information, we would request a first indication in your response to this letter of:

- the total number and total capacity of DG projects whose full commissioning dates are between 1 April 2000 and 31 March 2003; and
- the total number and total capacity of DG projects whose full commissioning dates are between 1 April 1995 and 31 March 2000.

2. Interim Period Forecast DG Information

This section covers all DG projects that are forecast to be fully commissioned during the interim period of this price control, ie from 1 April 2003 to 31 March 2005. We envisage adopting the same structure as set out for the historical DG information, as in Tables 2.1, 2.2 and 2.3.

3. Future Baseline DG Information

This section includes forecast information relating to DG projects that the DNOs have already considered reasonably detailed plans for, and that are expected, with reasonable confidence, to be fully commissioned within the next price control period, ie from 1 April 2005 to 31 March 2010.

The information request under this section will follow a similar structure to those in the previous sections, and consists of Tables 3.1, 3.2, 3.3.

4. Future Incremental DG Information

It is widely recognised that there is significant uncertainty in the development of DG, in terms of total volume, type, individual size and location. This in turn could cause significant uncertainty in the impact on the distribution networks. Whilst it is not realistic to forecast the precise nature of such development and cost implications on the DNOs, we believe that it is nevertheless essential to gather the DNOs' assessment of any further incremental DG development in addition to those relating to individual DG projects reported in section 3.

Data that can realistically be collected in this section will necessarily be in broad terms. Any values, or ranges of values, that can be supplied will very much depend on the assumptions taken on the DG development. In order to improve consistency between the information submitted by the DNOs, our initial view is that a set of key characteristics could be defined for a number of DG scenarios. Such key characteristics could range from headline figures, such as an

overall percentage of the government's renewable targets being achieved, to more detailed features, such as a certain rate of uptake of domestic CHP plant in terms of a percentage of total domestic demand, a percentage of the available wind energy resources materialising into generating plant, or an economic case for biomass plant.

Individual DNOs are best placed to construct their own DG scenarios based on such common assumptions combined with their local knowledge of the potential for various types of DG. Against each scenario, the DNOs will then construct a set of investment and operational strategies to connect the DG and incorporate the DG in operating their networks in the most efficient manner. This section of the DG-BPQ, contained in Table 4, will include high level figures for the capital and operational expenditures resulting from each scenario, together with explanation on the major elements of the strategies identified by the DNOs. These will not only be used for the setting of incentives and determining cost allowances for the DNOs in relation to DG, but may also inform the scenario to be used in the main price control Forecast BPQ.

In order to develop further thinking in this area, we would welcome your views on:

- the appropriate number of scenarios; and
- the key characteristics that Ofgem should provide for defining the DG scenarios.

In addition, or as an alternative, it may be appropriate to request DNOs to provide information on DG capacity headroom currently available at various locations across their networks, and unit cost (£/kW and/or £/MWh) information for connecting DG at potential locations and/or different voltage levels under the defined scenarios. We would welcome your views on the practicality and appropriate format for providing such information.

Timetable for DG-BPQ

Ofgem's latest open letter on developing network monopoly price controls and the next distribution price control¹ gave an overall timetable for the distribution price control review. The key dates relevant to the DG-BPQ work stream are extracted below:

¹ Developing network monopoly price controls and the next price control review of the electricity distribution network operators – Ofgem, March 2003

21 March 2003 Consult on DG information request (4 week response period)
*mid May 2003 Issue draft DG-BPQ (4 week response period)
*mid July 2003 Issue final DG-BPQ (2 month response period)
(*Moved from late to mid month to allow the DG-BPQ completion prior to issuing the
Forecast BPQ request.)

This timetable is intended to enable Ofgem to set out the proposed framework for incentives on DNOs in relation to DG by the end of 2003 and to use relevant information in the subsequent work to determine the capital and operational expenditure allowance for the DNOs. However, it may well be appropriate to request further updated information from DNOs in relation to DG in 2004 to refine incentive rates.

Response to this letter

We would request that your response is received by 22 April 2003. It should be sent to:

Min Zhu
Technical Advisor
Ofgem
9 Millbank
SW1P 3GE
Email min.zhu@ofgem.gov.uk
Tel 020 7901 7060

It would be helpful if responses could be submitted electronically if possible. If you have any queries on the issues raised in this letter, please contact Min Zhu in the first instance.

Yours sincerely,

Martin Crouch
Director of Electricity Distribution