

**Structure of Electricity Distribution Charges  
Implementation Steering Group (ISG)**

**18 March 2004, Ofgem, 9 Millbank, London**

**Attendees:**

<b>Ofgem:</b>	Mark Cox (Chair) Martin Crouch James Richardson David Young Clover Powell	
<b>DNOs:</b>	Richard Smith Andrew Neves Peter Merrick Tony McEntee Max Lalli Malcolm Sugden Nigel Turvey Joe Hart	Aquila Networks EME EDF Energy SP Power Systems SSE UU WPD YEDL/NEDL
<b>Supplier Reps:</b>	David Tolley	npower
<b>Generator Reps:</b>	Malcolm Taylor Stephen Andrews	AEP RPA <sup>1</sup>
<b>Apologies:</b>	Nick Carter Jeremy Nicholson Sebastian Eyre	BGT (Supplier Rep) EIUG (Customer Rep) energywatch (Customer Rep)

**Introduction**

Mark Cox welcomed those present to the meeting. He introduced Stephen Andrews of ILEX, representing RPA/Alcan, who was replacing Peter Williams on the ISG. Stephen noted that David Porter would normally be attending but was unable to make the present meeting.

**1. Actions from the last meeting**

Clover Powell updated the group on the actions from the previous ISG meeting held on 29 January 2004. For the first action from the meeting, she explained that the connections sub group had met twice, on 10 February and 1 March. Ofgem had found the discussion within the group very useful, and would update the ISG on progress as part of the connection charging rules agenda item.

Clover Powell said that the completed version of Peter Williams' fault level paper had been circulated to the ISG group, and that any comments on this paper could also be picked up during the connections agenda item.

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<sup>1</sup> Ilex's representation of renewable generators is being partly supported by Alcan.

Clover Powell said that Ofgem's structure of charges project team understood from discussions with the Ofgem Connections team that the ENA group looking at the Electricity (Connection Charges) Regulations was intending to report to Ofgem shortly on progress. Richard Smith said that it was important to determine the process and timescales for enacting change to the Regulations, as he believed this may be necessary to fully introduce the revised arrangements in time for 1 April 2005. Mark Cox agreed that Ofgem would look into this and report back to the group.

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Clover Powell said that, at the 29 January meeting, a number of DNOs had stated that they would be in a position to discuss initial ideas on generator use of system charging (GDUoS) during the March meeting. She said that Malcolm Sugden of UU and Peter Merrick of EDF would be presenting initial discussion papers during the GDUoS agenda item.

Clover Powell said that Ofgem had considered how detailed charging issues such as standing charges and service capacity charges might fit into the ISG and the project timetable. She said that Ofgem saw the ISG's priority as facilitating the introduction of the interim regime, but that there may be more time in the summer to discuss the longer-term proposals and a broader review of charging issues.

## **2. Project Timeline**

Mark Cox provided an overview of the project timeline that had been circulated to the group with the draft licence modification proposals on 5 March. Paying attention to the key dates, Mark explained that the first significant milestone would be the publication of the April document, which would update interested parties on policy developments, build on the work of the ISG, and initiate the statutory consultation on the proposed standard licence condition modifications to distribution licences. Mark Cox explained that the statutory process would be undertaken in April in order for the new framework to be introduced prior to 1 July and to ensure GB compliance with the EC Directive.

Mark Cox said that, assuming the licence modification proposals were implemented in May, the next significant date was the submission of draft methodologies to Ofgem by DNOs in July for initial comments. Ofgem would expect final methodology proposals in September, to be followed by a period of industry consultation. Decisions on whether to approve methodologies would be issued from November 2004.

A number of DNOs said that they had concerns with the process and timetable. One DNO said that his organisation was not convinced that the EC Directive required changes to the regulatory framework. Mark Cox said that Ofgem's internal legal advice was that GB was not compliant under the current framework, and that modifications were necessary. Another DNO said that the timetable looked reasonable apart from the added complexity of the price control review, where final proposals would not be put forward until the end of November 2004. He said that it would be very difficult for DNOs to make detailed proposals of GDUoS charges until the final allowances were known. Martin Crouch said that the March price control document would firm up a number of proposals, and said that this would make the picture clearer for DNOs. He said that it would be appropriate for DNOs' draft methodologies to state where assumptions had been based upon decisions taken by Ofgem in the March document.

Mark Cox said that Ofgem's timeline required DNOs to publish indicative UoS tariffs with their proposed methodologies. For clarity, demand tariffs would be based on revenues for 2004-05 as the final allowed revenues for 2005-06 may not be known at this time due to the price control. If the methodology was unchanged, hence the tariffs unaffected, then the DNO should state that. If the methodology proposed differed from that used to set the 2004-05 tariffs, the submission should show the impact of the new methodology on tariffs.

A generator representative remarked that the GDUoS deliverables already seemed to be slipping based on the Ofgem timeline. He said that the timeline showed that as of the date of the ISG meeting, DNOs should have completed initial work on the development of GDUoS charges. He added that generators wanted to be involved in the process of developing GDUoS charges.

A DNO said that his organisation's biggest concern was the lack of clarity in the process for approving methodologies. Mark Cox explained that Ofgem would set out its thoughts on the process in the April update document.

A supplier representative welcomed the proposal to introduce methodology statements on the grounds that it would give users the opportunity to gain a better understanding of where costs were likely to change in the future. He said that this was not possible using only the existing charging statements. A generator representative agreed, and said that it was entirely appropriate for Ofgem to press DNOs for more transparency.

A DNO asked whether methodologies would need to cover EHV charges as well as the regulated market. Martin Crouch confirmed that this was the case. A different DNO asked whether the new licence obligations would apply to new distribution market entrants. Martin Crouch confirmed that all licence holders would be required to meet the requirements of the proposed licence obligations.

### **3. Connection charging rule – interim solution**

Mark Cox provided an update on the progress of the connections sub group. He said that the group had been productive, and that Ofgem had found group members' input useful when developing policy.

Mark Cox said that a note summarising the progress of the sub group had been circulated to the ISG prior to the day's meeting, and that he was keen to discuss the decisions in the note with the wider ISG.

He said that the first development was the decision to combine the voltage and thermal rules into one security requirement rule. He said that the sub group had felt it more appropriate to have a cost apportionment rule based on the effective network capacity to meet security criteria rather than to have separate rules. He explained that Ofgem's preferred approach was for a rule where the proportion is calculated by the required capacity divided by new network capacity. He said that Ofgem believed that this rule was straightforward and practical to apply, broadly cost reflective, and also that the rule would work effectively in most scenarios.

One DNO said that his preference was to introduce a utilisation factor in the calculations so as to result in a fairer allocation of costs.

Another DNO said that he was not entirely comfortable with the proposed rule as he believed it to be discriminatory. He gave the example of an existing transformer of 500 KVA, fully utilised by existing load of 500 KVA. If a new customer requiring 300 KVA connected, a transformer upgrade to 800 KVA would result in the calculation  $300/800$  to determine the proportionate share of the new assets payable by the new connectee. This would mean that the generality of users would pick up the remaining  $500/800$ . The DNO representative said that this seemed to discriminate.

Martin Crouch said that it was important to consider the reasons for the costs being incurred. He said that were the existing customers not present, the upgrade costs would not have arisen, and so the costs would not be due entirely to the new connecting party. Because the costs were partly due to customers that were already connected, it would be appropriate for existing customers to bear a proportion of the cost.

A generator representative asked Ofgem to explain the reasons why it had ruled out the other two rules detailed in the paper. Mark Cox said that rule (b) was more complicated than rule (a), and that in rule (c), scenarios could arise where the connecting party would bear a disproportionate share of the costs.

Another generator representative asked Ofgem to confirm that the rules would apply to both generation and demand connections. Mark Cox confirmed that this was the case. The generator representative said that it was therefore very important for Ofgem's April consultation to flag up the issue of generator connections contributing to system security under P2/5. Ofgem noted this.

A generator representative asked Ofgem whether there was scope for the rules to change before 2010, the deadline for the introduction of the longer-term arrangements. Mark Cox said that it would be for DNOs to come up with proposals as to how the charging methods could be improved and these could be assessed through the proposed framework. He said that Ofgem did not want to preclude the possibility of DNOs moving to more detailed charging models including long run incremental cost models much sooner than 2010 if this could be done.

Mark Cox said that the second rule the sub-group had discussed was the fault level requirement for reinforcement rule. He said that Ofgem's preferred choice was the first rule (a).

A DNO who had sat on the sub group said that he saw merit in the rule, but was not convinced that it would give appropriate costs signals at higher voltages. Mark Cox said that he had noted in his paper that locational cost signals might need to be complimented at higher voltages, where costs are more easily identified with locationally varying GDUoS charges.

A generator representative said that the order in which the rule was applied was important in ensuring that the most appropriate answer was arrived at. He said that this issue would cause confusion in the case of future connection scenarios and urged Ofgem to make a statement in the April document so as to steer DNOs.

A DNO raised the issue of recovered assets, depreciation and modern equivalent asset values (MEA), and asked for confirmation of whether the customers should gain from the value of the asset. Another DNO said that this issue would be best handled by DNOs in methodology statements. Ofgem stated that with the proposed apportionment rules the

remaining asset value should be retained by the DNO on behalf of customers in general for future use on the system where appropriate.

A DNO representative said that Ofgem's paper had evolved through discussions within the ISG and at the sub-group from an original paper by Dave Miller of YEDL/NEDL. ISG members asked if the original paper could be circulated. Ofgem agreed to circulate the paper.

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Mark Cox said that Ofgem's paper also covered the issue of contribution to existing reinforcement assets. He said that the sub group had agreed that including a charge for contribution to existing reinforcement assets was appropriate as this would provide signals to deter second comers free riding. He said that it was also agreed that such a charge was possible under the E(CC) Regulations. He added that while some DNOs had argued that while the use of average costs would be the preferred methodology, Ofgem did not believe that this approach could be argued under the current version of the Regulations. He said that DNOs would therefore have to use actual costs incurred in the calculations.

A DNO who had attended the sub group said that he did not recollect this way forward being agreed by the sub group, and said that he understood that the issue had been left open for further discussion. There was discussion of the workability of the rules and the application of the rules using the current Regulations. One DNO said that there was a compromise that would need to be found between accurate and cost reflective charging arrangements and the complexity of introducing such rules.

Sub group attendees confirmed that they had found the group to be very useful. A DNO asked whether Ofgem would be convening another group meeting or whether the paper presented to the ISG was final. Mark Cox confirmed that it was not proposed for the sub-group to meet again. He said that Ofgem would now work the paper up into a draft guidance note to be included in the April update document.

#### **4. Generator use of system charges – interim solution**

Malcolm Sugden presented United Utilities's (UU) worked example of how the Generation Use of System charge might be applied to their distribution services area, and there was some discussion on what scenarios were represented by the GDUoS tables. A generator representative noted the wider principle that GDUoS charges should not recover an amount greater than would have been paid under deep connections.

The group considered concerns about volatility. The example presented to the ISG suggested a spike in prices might occur, and UU noted that the example assumed significant strategic investment. Martin Crouch suggested some concerns that the GDUoS values did not match up to the figures provided earlier in the paper, but another DNO suggested that this did not necessarily impact on the validity of the methodology. The group discussed the period of time that the reinforcement assets would be depreciated over and noted that this was 15 years in the example presented. A generator representative noted that this was a shorter period of time than normal distribution assets, and would result in a higher charge to generators.

Another DNO offered rough figures of between £3 and £8/kW as GDUoS values, and said that it was his company's view that there would be little in the way of major strategic reinforcement costs, and that the GDUoS would at first be a simple charge.

Generator representatives reiterated their concern that prices should be as stable as possible. Several DNOs suggested that greater penetration would widen the charging base and thus produce a more stable charge. A generator representative commented that a consequence of unstable charges was that they created uncertainty which in turn would make generation projects un-bankable.

Consideration was given to whether DNOs were expecting to charge the G-DUoS ahead of the reinforcement work being completed. The DNOs suggested that they would be in favour of undertaking such an approach. A generator representative raised the concern that this would leave generators liable to pay a use of system charge before they were even able to export electricity, and that this would be difficult to manage if they weren't able to capitalise such expenses.

The group considered the possibility of charging LV generation, and DNOs suggested that this might help widen the charging base. One DNO commented that new data flows and the need to adapt billing systems could necessitate significant investment in DNO IT systems. This point was supported by other DNOs. Some DNOs felt that there would be little impact from LV generation until there was significant penetration, and they would not therefore warrant charging.

Peter Merrick presented some initial thoughts on the GDUoS, noting that EDF envisaged there being differences between the interim and long term arrangements. Peter noted that EDF shared other DNOs concern over billing systems, and that the BSC modification on P81 could also raise problems. A supplier representative noted that customers with mixed sites would not be keen to have separate bills for demand and generation. DNOs said that this depended on how MPANs were registered, and that they had limited control over such data.

Mark Cox suggested that it might be appropriate for a GDUoS sub group to be convened to consider these matters further, and progress work both on the structure and content of use of system charging methodologies and on the practical matters associated with billing systems. Ofgem would send out an invitation suggesting some possible dates in April.

**Action: Ofgem**

## **5. Licence modifications**

James Richardson introduced the draft licence modifications, and said that the intention was to highlight the main points for discussion, building on some comments provided by group members in advance of the meeting.

### *Condition 4: Charges for use of system*

DNO representatives raised some queries over how the methodology approvals process would work. One was concerned about what would happen if a DNO methodology was not approved, but Martin Crouch made it clear that all efforts would be made to avoid this situation. Another group member asked about the logistics of giving notice of changes to charges in November 2004, with Ofgem methodology approval not due to

be granted until November or December 2004. Martin Crouch said that Ofgem recognised that this was a price control year, and that this might affect what information DNOs would have available for submission in November. Another DNO suggested that some useful slack could be built into the timeline by reducing the notice period for changes to charges from five months to three this year, rather than from 1 April 2005.

*Condition 4A: Use of system charging methodology*

Group members suggested that the change process might be easier to manage if DNOs were obliged to review methodologies annually, rather than constantly. A DNO representative asked whether some reference to DNOs duties under the Act should be included in 'the relevant objectives'.

Another DNO representative asked about the possibility of an appeals process for decisions on changes to charging methodologies. Martin Crouch said that it may not be possible to build this into the licence.

James Richardson explained how the change process would work, and said that it was hoped that the system would ease the burden of DNOs having to conduct consultations on all methodology changes. A supplier representative noted that, other than significant changes consulted upon by Ofgem, users would not be aware that changes were being made. Ofgem said that it would consider this matter further.

*Condition 4B: Connection charging methodology*

James Richardson explained the difference between the connection and use of system approaches, and noted to the group that the proposed statement combining methodology and connection charges would be very similar to what DNOs currently produced. A DNO representative questioned how Section 16 and Section 22 connections would be covered under the new regime, and suggested that asking DNOs to set out how Section 22 connections should be dealt with would restrict their ability to offer bespoke connections. The group discussed possible situations where the DNO and the connectee might prefer to be able to tailor the terms of the connection rather than stick to a prescriptive methodology, and suggested that this was an area for further consideration.

A DNO raised a query about paragraph 7, asking whether a connection offer made according to one methodology might become void if the methodology was amended before the connection was finalised, requiring the DNO to quote for the connection again.

The group considered paragraph 9(c). A DNO representative queried the benefits of including sub paragraph iii and suggested that it might not be appropriate to commit DNOs to the charging regime implied by 9(c)iii yet. He suggested that, in their area at least, the chances of fully locational DUoS charges being applied to any but the largest customers was slim, and that such a major change should be consulted upon at a later date. A generator representative expressed a concern that the removal of iii could lead to interim charging solutions becoming permanent, and Mark Cox said that the intention of the licence drafting was to provide a broad framework within which changes could be made via charging methodologies. Ofgem committed to re-examine the drafting of paragraph 9, but noted that some provision against double counting of costs would have to be included.

A generator representative asked whether it could be stated that this condition applied to generators as well as demand customers, since this was a substantial departure from the current regime. Ofgem agreed to consider whether this was necessary for clarity.

A DNO representative queried paragraph 14, asking what examples would be required. Currently, DNOs produced charges for various items, so that customers could estimate charges themselves. A generator representative noted that NGC publishes its charging model, allowing customers to calculate their exact charges. DNOs had some hesitations about the practicality of this, given the number of connections covered, but Mark Cox reminded the group that the licence drafting included the caveat 'where practicable'.

A DNO noted that paragraph 19(b) seemed to be formalising the requirement to facilitate competition in connections, and was of the opinion that Ofgem had previously avoided this.

*Condition 4D: Requirement to offer terms for use of system and connection*  
*Condition 4E: Functions of the Authority*

The group noted that Condition 4D was largely based on present licence condition 4B, and had no further comments.

James Richardson also noted that Condition 4E was also based upon the present licence (Condition 4C), with provision made to ensure compliance with the EC Directive Article 23, paragraph 5 on dispute resolution. Ofgem and the group agreed that further consideration should be given to the question of whether Ofgem would have powers to deal with complaints over the charging methodologies themselves, or merely the accurate derivation of charges from those methodologies, since these issues were not entirely clear in either the licence drafting or the EC Directive.

Mark Cox thanked the group for all their comments, and said that Ofgem would consider all the matters raised further.

**Action: Ofgem**

## **6. April document**

Mark Cox informed the group that the April document's main contents would be an update on SoC progress and the Section 11 notice and proposed licence modifications. Publication was currently planned for the first half of April, and Ofgem noted a DNO request to take account of Easter in setting the consultation period.

## **8. AOB**

Stephen Andrews asked if Ofgem was aware that microgenerators were keen to be represented on the ISG. Mark Cox said that Ofgem was aware and was happy to consider this, and the group also had no objection. Stephen Andrews said that the most likely candidate was Dave Sowdon, Chief Executive of the Micropower Council, and Stephen Andrews would ask him to contact Ofgem.

**Action: Stephen Andrews**

Andrew Neves informed the group that he would be attending a meeting on P81 the following week to represent DNO views on moving the boundary to 100kW, which may have implications on GDUoS charges for smaller parties.

David Tolley told the group that his economic model was now working, but the reliability of the results it was producing was not certain. He would be happy to present it to the group when time allowed.

## **9. Next meeting**

Mark Cox asked the DNO representatives to consider use of system models further before the next meeting, bearing in mind the timetable for the approvals process.

He said that Ofgem would be happy to discuss any further issues or concerns in the meantime, and would much prefer to deal with these things sooner rather than later.