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Direct Dial: 020 7901 7255  
Email: [martin.crouch@ofgem.gov.uk](mailto:martin.crouch@ofgem.gov.uk)

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Dear colleague,

## **2006-07 electricity distribution EHV use of system charges**

### *Background*

During 2004-05, the Distribution network operators (DNOs) developed their use of system charging methodologies for publication and approval. During this process, a number of companies announced their intention to change their methodology for calculating site specific charges at EHV from April 2005, and in some cases this caused a large disturbance in charges.

Following industry consultation, in February 2005 the affected DNOs' methodologies (CE Electric, EDF Energy, UU and WPD) were approved subject to a cap on the extent of increases in EHV charges and the condition that they put forward, by October 2005, proposals for a transition strategy for EHV charges from April 2006. It was expected that by October the companies would have a view of where long term charges would be moving, which would inform their strategy for the interim transitional period. The conditions were applied in the expectation that the DNOs would work towards developing new combined charging models for demand and generation in the next 12-18 months and implement full cost reflective prices by April 2007, with no transitional relief.

### *Update*

The DNOs and Ofgem have been working on development on the longer term charging framework during 2005. This has taken the form of a consultation document on options for a charging regime<sup>1</sup>, a public workshop<sup>2</sup> and continued discussion in the Ofgem/industry implementation steering group (ISG)<sup>3</sup>.

Three DNOs have recently submitted proposals to Ofgem regarding EHV transition strategies for April 2006. However, the companies have stated that they do not have data on the likely movement of charges over the coming years available to inform their suggested transition

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<sup>1</sup> Document reference 135/05 (May 2005), which is available from the Ofgem website at <http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/distributioncharges>.

<sup>2</sup> 24 May 2005, notes available from the Ofgem website [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11611\\_Workshopsummary\\_24May05.pdf?wtfrom=/ofgem/work/index.jsp&section=/areasofwork/distributioncharges](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11611_Workshopsummary_24May05.pdf?wtfrom=/ofgem/work/index.jsp&section=/areasofwork/distributioncharges).

<sup>3</sup> Minutes are published in the Electricity Distribution Charges section of the Ofgem website <http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/distributioncharges>

strategies, and will only have this data once further development of long term charging regimes has been carried out.

The proposals submitted so far take the following form:

- **EDF Energy** propose to follow the previous Authority decision and apply another 15% cap on April 2005 prices (ie a maximum 30% increase on charges from April 2004).
- **UU** has suggested applying the full increase to affected customers, bringing charges in line with the output from their current methodology. This would result in increases of between 21 and 33% from April 2005 prices (ie an increase of up to 48% from April 2004 prices for the worst affected customer).
- **WPD** have proposed a change to the way they apply their methodology to EHV customers, which shows some changes in EHV charges which reverse those seen in April 2005. Where the new methodology creates significant increases, they propose to cap these to 20% above April 2004 prices plus the general increase seen by all customers (RPI).

**CE Electric** (who are also under a condition to review and revise their charge setting model by 1 April 2006) have not yet proposed a transition strategy, but have indicated that a submission will be made to Ofgem by the end of October 2005.

#### *Future development of charging arrangements*

Each company is obliged by standard condition (SLC) 4(2) of their distribution licence to review their charging methodology at least once annually and make such changes as are necessary for the methodology to better meet the relevant objectives set out in SLC4(3). In particular, each methodology must facilitate competition in electricity generation and supply and should not adversely affect competition in transmission or distribution. Compliance with such a methodology should result in charges which reasonably reflect the costs incurred by the company in its distribution business.

The DNOs have recently presented their plans for future work on the development of long term charging arrangements collectively, via the Electricity Networks Association (ENA) Commercial Operations Group (COG)<sup>4</sup>. The DNOs have met twice so far to consider options, and Ofgem expects further updates in the future from this group on the viability and progress of this work.

Two of the companies have been involved in projects to develop long term charging models independently: UU, who have carried out some work with the University of Manchester, and WPD, who are currently working with Bath University. Ofgem is in ongoing discussion with these companies to understand progress and the likely implementation timing of any conclusions.

#### *April 2006 transition*

Having considered the options for the approach to be taken for EHV charges from April 2006, Ofgem considers that:

- Conditions were originally applied to the methodologies in the expectation that by this time (October 2005) more would be known of the likely future movement in charges, and this would therefore diminish the risk of customers being subjected to price changes which could be reversed upon implementation of long term models.

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<sup>4</sup> Presentation to the ISG, 27 September 2005. Slides and minutes of the meeting are available from the Electricity Distribution Charges section of the Ofgem website.

- o In the absence of robust views on the likely movement of charges from any of the affected companies, EHV charges should be increased in line with the retail price index (this is in line with the general increase seen by other customers).

The February 2005 decision stated that fully cost reflective charges should apply from April 2007 at the latest. The current decision is made on the expectation that the companies will make real progress on development of long term charging models in the coming months, and that the lack of longer term information will not be repeated for 2007 charges.

*Next steps*

CE Electric, EDF Energy, UU and WPD are required to propose transition strategies by 31 October 2005, in order to meet the condition on their UoS methodologies. Ofgem expects these companies to bring forward proposals in line with the views expressed in this letter. DNOs are required to set charges in line with their methodologies and to publish indicative charges three months in advance of any changes.

Any queries, comments or concerns about this letter should be directed to Mark Cox on 020 7901 7458 or [mark.cox@ofgem.gov.uk](mailto:mark.cox@ofgem.gov.uk).

Yours faithfully,



Martin Crouch  
Director, Distribution