



The Company Secretary
Central Networks East plc
Westwood Way
Westwood Business Park
Coventry
CV4 8LG

Promoting choice and
value for all customers

Your Ref: CNE/2008/03
rachel.fletcher@ofgem.gov.uk
Direct Dial: 020 7901 7194

CC: Andrew Neves (by email only)

7 April 2008

Dear Colleague,

Decision in relation to connection charging methodology and statement modification proposal CNE/2008/03: Capacity build-up on embedded networks

On 10 March 2008, Central Networks East plc ("CNE") submitted a proposal to the Gas and Electricity Markets Authority ("the Authority")¹ to modify its connection charging methodology and statement for its distribution network.

CNE has proposed to introduce a new method to deal with capacity requirements for embedded networks², which involves adjustments to its statement of use of system (UoS) charging methodology and the connection charging methodology and statement. This letter refers to the changes made to the connection charging methodology and statement.

Having considered the issues raised in the proposal, we have decided **not to veto** the proposed modification.

This letter sets out the background to the modification proposal, summarises the proposed changes and explains our decision.

Background

CNE has licence obligations³ to have in place as of 1 April 2005 a statement of UoS charging methodology, a statement of UoS charges and a connection charging methodology and statement. The connection charging methodology outlines the method by which connection charges are calculated. CNE has a requirement to keep the methodology under review and bring forward the proposals to modify the methodology that it considers better achieves the relevant objectives.⁴

¹ Ofgem is the office of the Authority. The terms 'Ofgem' and 'the Authority' are used interchangeably in this letter.

² Embedded networks include IDNOs, DNOs operating out of area and licence-exempt private networks.

³ Standard licence conditions 4-4B.

⁴ The relevant objectives for the connection charging methodology, as contained in paragraph 3 of standard licence condition 4B of the licence are:

- (a) that compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act 1989 and by this licence;
- (b) that compliance with the connection charging methodology facilitates competition in generation and supply of electricity, and does not restrict, distort or prevent competition in the transmission or distribution of electricity.

CNE modification proposal

- CNE has proposed to outline arrangements for capacity build-up on embedded networks within its connection charging methodology and statement. The proposed addition would state that an embedded network would pay connection charges based on the authorised supply capacity (ASC). The revised statement outlines arrangements for capacity reviews and capacity reservation in the longer term.
- CNE has also proposed to provide information relating to associated use of system charges, including a link to the relevant section of the statement of use of system charging methodology.

Ofgem's decision

We have considered this proposal against the relevant objectives and our wider statutory duties. We consider that this modification results in improved clarity to better enable customers to make an estimate of their likely connection charges. A connection charge based on the predicted total capacity requirement of a fully developed network reflects the costs incurred by CNE in its distribution business, and encourages efficient network development. Though this arrangement is currently in force we accept that this additional explanation is helpful due to the non-standard arrangements for embedded network UoS charges. CNE has proposed to modify its arrangements for embedded network UoS charges by levying a UoS charge based on current capacity uptake during a specified growth phase⁵. This differs from current arrangements which base UoS charges on the ASC.

The inclusion of a three year capacity review means that there is an incentive on the embedded network operator not to overstate long term capacity requirements since CNE could reduce the ASC to the capacity requirements at the time of review. To reserve capacity in the long term (i.e. beyond the three years) the embedded network operator would then pay use of system charges based on its total capacity requirements represented by the ASC, which would represent a further incentive to accurately forecast capacity requirements.

We have decided **not to veto** the modification to the connection charging methodology and statement.

Ofgem's comments

Whilst we welcome efforts to address issues relating to capacity build-up, we note the missed opportunity to discuss the issues with the industry. We consider that this is an industry-wide issue, and would encourage discussion of future proposals at industry fora.

CNE's proposal aims to address the issue of capacity requirements on embedded networks which often grow over time. However, other issues remain pertinent, which we raised in our decision to veto a previous charging modification raised by CNE⁶. CNE

(c) that compliance with the connection charging methodology results in changes which reflect, as far as is reasonably practicable (taking into account of implementation costs), the costs incurred by the licensee and its distribution business; and

(d) that, so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is practicable, properly takes account of developments in the licensee's distribution business.

⁵ For further information see modification proposal CNE 2008 02, available on the Ofgem website.

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgMods/Documents1/CNE%202008%2002%20UoS%20proposal.pdf>

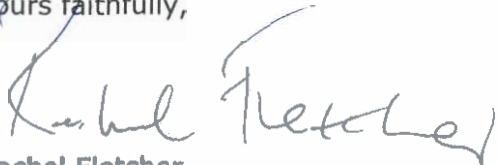
⁶ For further information see 'Decision in relation to proposal CNE 003 – introduction of IDNO-specific tariffs' (Ofgem, January 2008)

stated in its modification proposal that it is considering the aspects of our veto letter not covered by this modification, to be addressed in separate proposals, and we would urge CNE to expedite this process.

We also note CNE's claim in the modification proposal that the proposed arrangements for capacity build-up on embedded networks would mirror the way CNE treats its own customers. CNE's current charging statements do not currently reflect such capacity build-up arrangements. We urge CNE to review its charging statements in light of this.

Please contact Tom Handysides at tom.handysides@ofgem.gov.uk or on 020 7901 7289 if you have any queries relating to issues raised in this letter.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', with a stylized flourish at the end.

Rachel Fletcher

Director, Distribution

Signed on behalf of the Authority and authorised for that purpose by the Authority