



Electricity Distribution Licence  
holders

*Promoting choice and  
value for all customers*

Direct Dial: 020 7901 7194  
Email: [rachel.fletcher@ofgem.gov.uk](mailto:rachel.fletcher@ofgem.gov.uk)

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Dear Colleague

**Statutory Consultation on Collective Licence Modification proposal for a Common Distribution Charging Methodology for the High and Low Voltage networks**

Ofgem has published today a Collective Licence Modification (CLM) proposal (ref 48/09) titled: 'Next steps in delivering the electricity distribution structure of charges project: putting in place a licence obligation on Distribution Services Providers to deliver a common distribution use of system charging methodology and governance arrangements for the High and Low Voltage Networks for implementation with effect from 1 April 2010'<sup>1</sup>. The CLM proposal seeks to implement our decision<sup>2</sup>, that Distribution Network Operators (DNOs) should implement a common methodology for calculating use of system charges levied on persons connected to the High and Low Voltage (HV/LV) networks by 1 April 2010.

The CLM proposal is an outcome of our long running structure of charges project. Through this project, which commenced in 2004, Ofgem has been urging the DNOs to introduce more cost reflective charging methodologies. Revised charging arrangements are necessary to encourage large users in particular to make efficient siting and use of network decisions, and to reward users who provide a benefit to the distribution network, for example distributed generation (DG) located close to load or for customers implementing demand side management. DNOs are forecasting very significant load related investment (£2.3bn net of customer contributions) on their networks between 2010 and 2015 and in our view delivering the project in a timely manner is integral to promoting efficient network investment in this period and beyond, and to helping deliver against the government's climate change objectives. Revised charging methodology governance arrangements are also an important part of the project and it is our intention, as part of delivering the project, to implement more open governance arrangements which allow parties materially affected by the revised methodologies to formally raise modification proposals for consultation and consideration by industry.

In October last year we presented a licence proposal which required the DNOs to implement a common methodology and open governance arrangements across all distribution network voltage levels. We were unable to implement our proposed licence changes as there was opposition from two DNOs to our decision over the charging model to be implemented on the Extra High Voltage (EHV) networks. Following the October

<sup>1</sup> Documents referred to in this letter are available to view on our website at [www.ofgem.gov.uk](http://www.ofgem.gov.uk).

<sup>2</sup> The reasons for our decision are set out in two documents: Delivering the electricity distribution structure of charges project (ref.135/08), October 2008; and Next steps in delivering the electricity distribution structure of charges project (ref.24/09), March 2009.

document, in December<sup>3</sup> we consulted on the most appropriate way to take the project forward and in March we concluded that it would be appropriate to split the project between delivery at HV/LV and EHV level. To take the project forward at the lower voltage levels we decided that it remained appropriate for the DNOs to have a licence obligation to implement charges based on a common charging methodology and open governance arrangements for April 2010. At EHV level we decided to require each DNO to choose whether to apply a common long run incremental cost (LRIC) model or a common version of the forward cost pricing (FCP) approach developed by the G3<sup>4</sup> group. We intend to bring forward licence proposals in the coming months that seek to implement the charging and governance arrangements for those connected at EHV level.

If we are successful in implementing a common methodology and governance arrangements on the HV/LV networks it will represent an important step forward in the structure of charges project. The vast majority of customers (around 99%) are connected to the lower voltage networks. Responses to our consultations during 2008 provide strong evidence that a common methodology at the lower voltage levels will reduce the administrative and charge forecasting costs that suppliers incur and these savings will ultimately reduce energy costs to customers<sup>5</sup>. Users of the network also agree that open governance of the methodology will ensure that the benefits of commonality are preserved on an enduring basis and will make sure that the methodology adapts to changes in the needs of network users, particularly in the move towards a low carbon economy.

Since November of last year, under the auspices of the Common Methodology Group (CMG), the DNOs have been working together, without legal obligation, to develop a common methodology for implementation at HV/LV level<sup>6</sup>. We have supported this work and recognise that without it significant progress towards delivery of a common methodology at HV/LV level would not have been made. If our CLM proposal is implemented, it will provide the necessary legal framework for delivery of the benefits of the DNOs' work. We hope that the DNOs will support us in this essential step towards achieving the project's goal.

## **Delivering the HV/LV CDCM**

### *Timetable*

The statutory consultation on the CLM proposal will last for 28 working days and will conclude on 8 June. We will then indicate whether the proposal has been successful, and if it has, the CLM will come in to force by early July. Proposed condition 50.15 requires the DNOs to submit the CDCM and proposals for handling modification arrangements to the CDCM for approval by the Authority not later than 1 September 2009, but DNOs do not have to wait until this date and can bring forward their proposals before September if they are ready to do so. The Authority may then approve, veto or conditionally approve the CDCM and governance arrangements, and must provide the reasons for its decision in writing.

### *Issues relating to the CLM*

We highlight some of the issues that have been raised in relation to the drafting of the CLM along with how we have sought to address them below.

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<sup>3</sup> Next steps in delivering the electricity distribution structure of charges project (ref.160/08), December 2008.

<sup>4</sup> The G3 group comprised Central Networks, Scottish Power and Scottish and Southern Energy.

<sup>5</sup> More than 99% of distribution customers are connected at the lower distribution network voltage levels. Implementing a common methodology at HV/LV level would therefore deliver a significant part of the efficiency benefits industry and large suppliers associate with the structure of charges project.

<sup>6</sup> Detail of the CMG's work and associated workstreams is available on the Energy Networks Association website at <http://2009.energynetworks.org/structure-of-charges/>.

- *Governance*

On 25 March the CMG distributed a paper<sup>7</sup> proposing that the common methodology should be subject to the modification and change control procedure of the Distribution and Connection Use of System Agreement (DCUSA), and that incorporation of the common methodology within the DCUSA should be defined in the licence.

We do not agree that it is appropriate at this stage to define the location of the governance for the common methodology within the distribution licence as we have not consulted on this matter or allowed all parties to consider the alternatives to incorporation within the DCUSA. Furthermore we do not think it is necessary for the CLM to define the location of the governance arrangements, as this can be done after consultation by the DNOs and still allow time for incorporation into DCUSA (if this proposal meets with general support) ahead of April 2010.

Under proposed Condition 50.23 of the CLM governance arrangements are left open. DNOs are required to consult with other Authorised Electricity Operators and are required to bring forward their proposals for handling modification arrangements at any stage up to 1 September 2009. It is appropriate for us to consider the DNOs' governance proposals under this condition at that time as there will have been appropriate consultation. Should any consequential licence changes be needed to implement the proposals the DNOs put forward they can be dealt with at that time.

- *October and March decision on the common methodology*

The CLM proposal sets out clearly the legal obligation on the DNOs to deliver a CDCM for approval by the Authority by 1 September 2009. Proposed Condition 50.14 sets out that the CDCM must conform to such requirements as have been specified by the Authority in its decision given on 1 October 2008 and subsequently clarified and amended on 20 March 2009 with respect to the fundamental principles and assumptions on which the development of the CDCM is to be based. A number of DNOs have commented that this condition suggests that if the methodology deviates in any way from the March decision it will not meet the proposed licence requirement and that this condition does not take account of the ongoing work being undertaken by the CMG which has in some instances, following dialogue with Ofgem, concluded that there are more appropriate approaches than those specified in the March decision.

The decision given in our October document and subsequently clarified and amended in appendices three and four of our March document was intended to provide a set of working principles upon which the CDCM should be based. The documents also provide detail on areas where further thinking and development work is required by the DNOs, for example in developing tariff structures, scaling arrangements and in working with the independent DNOs (IDNOs) on IDNO charging arrangements.

Particularly in our October document, we were clear that although in some instances the requirements were categorical and did not require further interpretation, we anticipated that further work and consultation would be required to interpret and develop the common approach in other areas and that we were prepared to provide feedback as any issues were progressed. We are satisfied that to date the CMG has taken forward this work in an appropriate manner, and given that our responses to the issues referred to us by the CMG have been well documented, we do not consider that the drafting of proposed condition 50.14 should be viewed as overly prescriptive or as presenting a regulatory risk to the DNOs. We will continue to be open and flexible about the interpretation of our decision documents and are committed to working with the DNOs to aid progress in this respect.

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<sup>7</sup> The paper was distributed among Distribution Charging Methodology Forum (DCMF) members and was presented at the meeting of the DCMF on 3 April 2009. The DCMF is a forum comprising DNOs, suppliers, Independent Distribution Network Operators (IDNOs) and generators which regularly meets to discuss distribution network charging matters.

- *Definition of High and Low Voltage Networks*

Proposed condition 50 deals with the 'Development and implementation of a Common Distribution Charging Methodology' and qualifies the CDCM as being applicable to the High and Low Voltage Networks only. Our March decision document proposed modifying condition 1 by defining 'High and Low Voltage Networks' as meaning 'where the voltage of the assets on the distribution system is less than 22 kilovolts.'

A number of DNOs have commented that they currently apply their EHV methodologies to some customers connected at voltages of less than 22kV<sup>8</sup>. They are concerned that the requirement to apply the common HV/LV methodology to all customers connected at voltage levels of less than 22kV would prevent them from charging such customers on the basis of an EHV methodology in the future and, to the extent that their EHV methodology is more cost reflective than the proposed HV/LV methodology, that this might be counter to the overall objectives of the structure of charges project. To address this issue we have qualified the licence to allow such customers to continue to be charged outside the HV/LV CDCM.

We believe the proposed licence drafting is a pragmatic way forward at this stage. We are aware that currently different practices potentially apply between DNOs and we recognise that this issue has clear interactions with the implementation of common EHV charging methodologies. We expect the DNOs to review this matter and reach a common approach to the charging of such customers as part of the work on implementing common EHV methodologies.

### **Next steps**

We welcome the progress made by the industry to date in developing common arrangements for HV/LV charging and we are keen to continue to work with industry parties to deliver common HV/LV charging arrangements and associated governance for 1 April 2010. We are committed to continuing Ofgem involvement in the CMG to ensure we provide our thoughts on methodology issues as they arise.

The priority at this time remains delivery of HV/LV arrangements for April 2010. We intend to progress licence drafting for the extra high voltage (EHV) network levels through the summer with the intention of enabling EHV delivery for April 2011.

Yours faithfully



Rachel Fletcher  
Director, Distribution

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<sup>8</sup> For example, customers connected to the low voltage busbar of any substation with a primary voltage greater than 22kV.