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*Promoting choice and
value for all customers*

Your ref: UoS Mod 27
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Direct Dial: 020 7901 7194

cc: Oliver Day and Paul Measday
(by email only)

6 May 2009

Dear Colleague,

Decision in relation to EDF Energy Networks Limited use of system charging methodology modification proposal 27: Capacity management for Licensed Distribution Network Operators (LDNOs)

On 8 April 2009, EDF Energy Networks Limited (EDFEN) submitted a proposal to the Gas and Electricity Markets Authority ("the Authority")¹ to modify its use of system (UoS) charging methodology for its London (LPN), South East (SPN) and East of England (EPN) licensed distribution networks ("the EDF Networks").

EDFEN has proposed to introduce a new method to deal with capacity requirements for IDNOs and DNOs operating out of area² which involves adjustments to the EDF Networks' UoS and connection charging methodology statements. This letter refers to the changes made to the UoS charging methodology 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

The EDF Networks have licence obligations³ to have in place three charging statements: the statement of UoS charging methodology, the statement of UoS charges and the statement of the connection charging methodology and charges. The UoS charging methodology outlines the method by which UoS charges are calculated. The EDF Networks have a requirement to keep the methodology under review and bring forward the proposals to modify the methodology that they consider better achieve the relevant objectives⁴.

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

² Hereafter referred to as LDNOs.

³ Standard licence conditions 13-14.

⁴ The relevant objectives for the UoS charging methodology, as contained in paragraph 13.3 of standard licence condition 13 of the licence are:

- (a) that compliance with the UoS 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 UoS 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.
- (c) that compliance with the UoS 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

The IDNO/DNO boundary charging working group was established in October 2008 to develop common charging arrangements for IDNO customers.

EDFEN modification proposal

- EDFEN propose that where the UoS charge to a LDNO includes a capacity charge element this capacity charge will be allowed to grow over a 36 month period. Over this period the capacity charge will be levied on a monthly basis to reflect the maximum recorded usage to date. The proposal states that the starting point for such UoS capacity charging is zero kVA.

Ofgem's decision

We have considered this proposal against the relevant licence objectives and wider statutory duties. We have considered other capacity ramping proposals in the recent past where we have provided a non-veto decision.

This modification addresses the particular characteristics of LDNO connections, particularly growth of capacity requirements over time. We consider that for this type of scenario it is appropriate to put in place commercial arrangements for phasing of capacity requirements. By allowing an LDNO to pay capacity charges based on capacity uptake over an initial development period of connection rather than the agreed connection capacity, any phasing proposal reduces the risk of restricting, distorting and preventing competition in the distribution of electricity, and therefore better achieves SLC 13.3(b). This is because capacity charges would more closely reflect actual usage during the period the site is developing which is then more in line with the way EDFEN treats capacity development on its own network. The current treatment is to charge at the outset for the full capacity the site requires once it has reached maturity.

Charges for LDNOs should be structured in a similar way to the host DNO's all the way charges (which do not include capacity charges for domestic sites) in order to minimise the risk of anticompetitive effects. This has the potential to better ensure competition is not restricted, prevented or distorted under SLC 13.3(b). We consider that by reducing the impact of capacity charges during the initial period of connection this proposal represents a step towards the longer term arrangements we expect DNOs to have in place for IDNOs.

We note that this type of modification, and any linked amendments to the connection charging methodology statement, could have the effect of encouraging LDNOs to request capacity in excess of its requirements where this does not affect its connection charge. This could mean that another potential connecting customer would notionally trigger additional reinforcement because of the excess capacity that must remain available to the LDNO. However, the licence obligation on DNOs and other operators of licensed networks to develop the network efficiently should serve as a counterweight to excessive capacity requests. In addition, the incentive to overstate capacity is mitigated by the fact that full capacity charges are paid after 36 months.

It should be noted that the processes and legal tests in relation to charging modifications and any Competition Act 1998 investigation are separate and distinct. Therefore, in taking this decision, Ofgem does not limit or prejudice any findings which the Authority may make in relation to the current investigation of Electricity North West Ltd under the Competition Act 1998.

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

On the basis that we consider that the proposal better achieves the relevant objective under SLC13(b) we have decided **not to veto** the modification to the UoS charging methodology statements.

Please contact Colette Schrier by email colette.schrier@ofgem.gov.uk or on 0207 901 7341 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', is positioned above a light grey rectangular box.

Rachel Fletcher

Director, Distribution

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