

Electricity Distribution Price Control Review Initial Licence Drafting Consultation

Document type: Consultation

Ref: 128/09

Date of publication: 20 October 2009

Deadline for response: 17 November 2009

Target audience: Consumers and their representatives, distribution network operators (DNOs), independent distribution network operators (IDNOs), owners and operators of distributed energy schemes, transmission owners, generators, electricity suppliers, the Department of Energy and Climate Change (DECC) and any other interested parties.

Overview:

This document sets out our initial views on the changes to the DNOs' licence conditions that we think are necessary to bring our proposals for the next Distribution Price Control Review (DPCR5) into effect. The proposed changes are broadly consistent with our Initial Proposals for DPCR5 which we set out in August this year. In some places, the draft licence conditions reflect further policy development since August.

We invite views on the draft licence conditions. At this stage we are not consulting on the policy itself. We will hold a further consultation on the licence conditions once we have issued our Final Proposals for DPCR5 later this year.

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Context

We began the Electricity Distribution Price Control Review (DPCR5) in March 2008. Since then we have issued a number of consultation documents, including our Initial Proposals in August this year. In that document we set out our initial proposals for the revenues the DNOs should be allowed to earn between 2010 and 2015. We also set out the outputs and behaviours we would like from the DNOs over this period and the incentives, funds and obligations we propose to use to encourage them. We will publish our Final Proposals later this year. If the DNOs accept them, the new arrangements will come into effect on 1 April 2010. If they do not, we may refer the matter to the Competition Commission.

Ahead of 1 April 2010 we need to ensure that the DNOs' licence conditions reflect our Final Proposals. We have formed a DPCR5 legal drafting working group (LDWG) with the DNOs to help develop the new licence conditions. While the LDWG is working well, we think it is important to get the views of other stakeholders on how the licence drafting is developing at an early stage of the licence drafting process. Sharing the work in progress also enables us to highlight potential modifications to the licence conditions which may not be apparent from earlier DPCR5 consultation documents, including our Initial Proposals.

The licence drafting consultation also provides us with the opportunity to review the DNOs' licences and seek improvements, not associated with DPCR5, where appropriate. In this regard we propose a change to the structure of the price control licence conditions (also referred to as the special licence conditions) to align them more closely with the standard licence conditions in both style and format. This and other house-keeping changes (including a review of the defined terms in the special licence conditions) are to reflect the conclusions of the Distribution Licence Review last year.

We will hold another consultation on the licence drafting later this year following publication of Final Proposals.

Associated Documents

- Electricity Distribution Price Control Review – Initial Licence Drafting Consultation – Appendices, 20 October 2009 (Ref. 128a/09)
- October Update to Initial Proposals, 5 October 2009
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=323&refer=Networks/ElecDist/PriceCtrls/DPCR5>
- September Update to Initial Proposals, 21 September 2009
http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/September_Update_letter.pdf

- Electricity Distribution Price Control Review - Initial Proposals, 3 August 2009 (Ref. 92/09)
http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Initial%20Proposals_1_Core%20document.pdf
- Electricity Distribution Price Control Review - Initial Proposals - Incentives and Obligations, 3 August 2009 (Ref. 93/09)
http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Initial%20Proposals_2_Incentives%20and%20Obligations.pdf
- Electricity Distribution Licence Review: Conclusions and Statutory Consultation, April 2008 (Ref. 50/08)
http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/DLR%20Conclusions_letter.pdf
- Electricity Distribution Licence Review Proposals, October 2007 (Ref. 259/07)
<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/DLR%20Proposals%20consultation.pdf>
- Distribution Price Control Review - Final Proposals, November 2004 (Ref. 265/04)
<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR4/Documents1/8944-26504.pdf>

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Summary

Ofgem regulates the 14 monopoly regional distribution network operators (DNOs) to protect the interests of current and future consumers. We set a price control every five years that sets the maximum revenues that each DNO can collect from customers at a level that allows an efficient business to finance its activities. We also place incentives on DNOs to innovate and find more efficient ways to provide an appropriate level of network capacity, security, reliability and quality of service.

The current price control is expected to expire on 31 March 2010. This electricity distribution price control review (DPCR5) will set the price control for a five year period from 1 April 2010. We are currently developing our proposals for the price control in consultation with interested parties. Our Initial Proposals were published on 3 August 2009. We intend to publish our Final Proposals later this year.

This document sets out our preliminary views on the modifications to the DNOs' licences we will need to make in order to implement the price control. We explain the rationale for the proposed changes in this document and in the appendices we set out the latest draft licence modifications. In a number of areas we are still developing and consulting on our price control proposals, so our proposed licence conditions are still in draft form and subject to change.

In some policy areas our thinking has evolved since our Initial Proposals consultation document and we have tried to reflect this in the licence drafting. This applies, for example, to our licence drafting in relation to the Innovation Funding Incentive and the losses incentive scheme.

Many of our initial proposals entail minor drafting changes to the licence conditions. However, in a number of cases we think we need substantially new licence conditions to implement our proposals. These include the Low Carbon Networks fund and connection margins.

This document also includes our initial views on more general improvements that can be made to the licence conditions and seeks views on these proposed improvements. These improvements mainly concern changes to the special licence conditions to make them more clear and user-friendly. For example, each special licence condition now begins with a statement as to its purpose.

We would like to hear from stakeholders whether the work so far is successful in capturing the policy intent we set out in our Initial Proposals and whether the proposed improvements make the licence clearer and more user friendly.

Some of our proposed modifications will also apply to independent distribution network operators (IDNOs) to ensure that customers have the same level of protection regardless of whether they are connected to the network of a DNO or an IDNO. We highlight in this document where that will be the case and we seek feedback from IDNOs and other stakeholders on these modifications.

1. Introduction

Chapter Summary

This chapter sets out the purpose of the document, summarises the licence modifications that are likely to affect electricity distribution network operators (DNOs) and independent electricity distribution network operators (IDNOs) and explains how the document is organised.

Question 1: Do you think our proposed timetable for the implementation of changes to the licence conditions and other legal instruments (set out in this chapter) is appropriate?

Introduction

1.1. The 14 DNOs are regional monopolies and customers rely on regulation by Ofgem, rather than choice and competition, to get the service they require at a reasonable price. We set the total revenues that DNOs can collect from customers and we place incentives on DNOs to innovate and find new ways to improve their efficiency and quality of service. This is achieved through a price control which we set every five years. The current price control (DPCR4) is expected to expire on 31 March 2010 and we are conducting a review (the fifth distribution price control review or DPCR5) to set the controls for 1 April 2010 to 31 March 2015.

1.2. We have already set out our Initial Proposals for the revenues companies should be allowed to earn in the next five years. We have also set out the new obligations and incentives we propose. The new arrangements we propose to put in place to reset the revenue allowances for the 14 DNOs from 1 April 2010 will be set out in our Final Proposals later this year.

1.3. If our Final Proposals are accepted by the DNOs we will need to reflect the new arrangements in the DNOs' licence conditions and these will need to be in place by 1 April 2010. The new arrangements will require new Regulatory and Instructions Guidance (RIGs). RIGs are intended to facilitate the collection of information on a common basis and to an appropriate degree of accuracy by each DNO and so, in turn, to enable Ofgem to monitor compliance by each DNO with the price control conditions.

1.4. The new arrangements will also require new guaranteed standards of performance regulations. Specifically, we propose to amend the Electricity (Standards of Performance) Regulations 2005 (SI 2005 No 1019) and introduce new Electricity (Connection Standards of Performance) Regulations. Interested parties will shortly be given the opportunity to comment on these two regulations separately.

1.5. Certain aspects of the new arrangements may also be reflected in our Final Proposals document, in particular in Appendix 1 of that document, rather than in legal drafting. This is likely to be the case where the treatment of a particular issue is uncertain and subject to change during the DPCR5 period (e.g. regulatory asset value (RAV) additions). These issues will be addressed in more detail in our Final Proposals later this year.

Purpose of this document

1.6. We have begun working on the drafting to implement the licence conditions, RIGs and regulations. We are working closely with the DNOs to this end. The DNOs (on whom all of the licence modifications directly and immediately impact) have been and continue to be involved in the licence drafting process through the forum of the DPCR5 legal drafting working group (LDWG). Preparation of the current draft licence conditions has been greatly assisted by the peer review function of the DPCR5 LDWG which comprises representatives from Ofgem and the DNOs¹ and which will continue to meet until the licence modifications are finalised. The DNOs are therefore well aware of the progress to date of the legal drafting.

1.7. However, we want to ensure that other stakeholders have an opportunity to comment on the proposed drafting at an early stage, before it is further developed. The purpose of this consultation therefore is to seek comments on early drafts of the licence modifications with a view to drawing out any concerns of interested parties at an early stage.

1.8. We would emphasise that this consultation document does not seek comments on our policy proposals. The focus of this document is the form and structure of our proposed legal drafting to implement DPCR5 policy; its focus is not the policy itself. Our policy proposals have been the subject of a separate DPCR5 consultation documents. Accordingly, responses to this consultation document should be limited to comments on the detail of the legal drafting and its workability.

Other / house-keeping changes to licence conditions

1.9. We also propose to make a number of changes to the licence conditions that are not directly related to our DPCR5 proposals. Most of these changes come out of our Electricity Distribution Licence Review (DLR) which we concluded last year. The DLR was a review by Ofgem of the standard conditions of the electricity distribution licence. The aim of the review was to ensure that the standard licence conditions

¹ For further information on the DPCR5 LDWG, please see Appendix 2 to Electricity Distribution Price Control Review Initial Proposals – Incentives and Obligations: http://www.ofgem.gov.uk/NETWORKS/ELECDIST/PRICECTRLS/DPCR5/Documents1/Initial%20Proposals_2_Incentives%20and%20Obligations.pdf

were fit for purpose and met the principles of Better Regulation. As a result, changes were made to the standard licence conditions to improve their clarity and usability.

1.10. The electricity distribution licence is made up of two main types of licence conditions – standard conditions and special conditions. The standard licence conditions apply to all electricity distributors (i.e. DNOs and IDNOs).² The special licence conditions, however, apply only to the DNOs and also contain provisions that are specific to licensees. A DNO's ability to recover revenues up to the value determined by the price control model is addressed in the special licence conditions. Having made changes to the standard licence conditions last year as part of the DLR, we consider that improvements can now be made as part of DPCR5 to the special licence conditions.

1.11. In line with the DLR, the changes we propose to make to the special licence conditions are to improve their clarity and usability, to consolidate related provisions where appropriate and to remove obsolete provisions. This has led to the restructuring of each special licence condition as well as an overall regrouping (and consequent renumbering) of those conditions. The special licence conditions have also been renamed "charge restriction conditions" or "CRCs" to reflect more accurately their purpose.

1.12. These changes are also intended to ensure that the special licence conditions are consistent with the standard licence conditions. This means, for example, that each special licence condition will be restructured to include an opening statement as to its purpose. In addition, as highlighted in the DLR Proposals,³ we will review the defined terms in the special licence conditions to reflect, where appropriate, changes to the standard licence conditions.

1.13. Interested parties' comments are also welcome on these other proposed changes.

Impact of the modifications on the IDNOs' licence conditions

1.14. Although DPCR5 primarily affects DNOs there are some issues, such as the quality of service arrangements, which we consider should apply to IDNOs as well as DNOs to ensure that customers have the same level of protection regardless of

² Although Section B of the standard licence conditions are not switched on for (and therefore do not apply to) IDNOs.

³ See paragraph 2.42 of DLR Proposals, October 2007 (Ref. 259/07):
<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/DLR%20Proposals%20consultation.pdf>

whether they are connected to a DNO's or an IDNO's network. These areas are summarised in paragraphs 1.15 and 1.16 below.

1.15. We intend to come forward with the proposed changes to the IDNO licences in our second licence drafting consultation. In the meantime however we would highlight that our proposed modifications are likely to affect IDNO licences in the following ways:

- SLC 1 and 2 - changes to definitions and interpretation of the licence,
- SLC 15A – a new condition to support the introduction of new regulations relating to connection guaranteed standards, and
- SLCs 17 and 35 - consolidation of the requirements to offer terms for metering point administration services and data services.

1.16. In addition the proposed amendments to the Electricity (Standards of Performance) Regulations 2005 (on which interested parties will be invited to comment separately) will also apply to IDNOs.

Status of our licence drafting work

1.17. The licence drafting appended to this document is work in progress and subject to change. There will be a number of iterations of the licence conditions before drafting is finalised, including in the course of reviews by the DPCR5 LDWG. As such, the licence drafting appended to this consultation document is not legally binding.

1.18. We would note too that the licence drafting appended to this document is not complete. We highlight in Chapter 2 where further work is required to reflect DPCR5 proposals and whether this is due to ongoing licence drafting or policy discussions. We also highlight (using square brackets) these instances in the licence drafting contained in Appendices 7 and 8.

1.19. The licence drafting largely reflects policy as set out in our Initial Proposals. In certain areas, however, policy has evolved since the publication of Initial Proposals in August 2009. This is true especially of areas like the Innovation Funding Incentive and losses. We therefore indicate in Chapter 2 of this document where licence drafting has gone beyond the policy position set out in our Initial Proposals.

1.20. We are developing our DPCR5 proposals to address comments we have received since publishing Initial Proposals and also to ensure that, overall, the arrangements represent an appropriate balance of risk and reward. To assist us, we

have in place a number of working groups⁴ at which we discuss the detail of policy matters and consider refinements. We also have a number of scheduled meetings with the DNOs and other stakeholders in the lead up to Final Proposals. We would highlight that any development in policy since our Initial Proposals is subject to approval by the Authority and subject to change for this reason also. The Authority will discuss and approve DPCR5 policy proposals when it meets to consider Final Proposals next month.

1.21. Finally, it should also be noted that not all licence conditions will be affected by our DPCR5 proposals. A table setting out the licence conditions that are likely to be affected by DPCR5 is contained in Appendix 6.

Next steps

1.22. We will invite comments from interested parties later this month on the two sets of regulations relevant to DPCR5, namely modifications to the Electricity (Standards of Performance) Regulations 2005 and the new Electricity (Connection Standards of Performance) Regulations.

1.23. We will also continue to hold meetings of the DPCR5 LDWG over November and December 2009 to further refine the draft licence conditions. We will hold separate discussions with the IDNOs and other interested parties where appropriate.

1.24. As indicated above, we intend to hold a second consultation on the licence conditions after the publication of Final Proposals later this year. The second consultation document will include draft licence conditions for the IDNOs as well as the DNOs. It will also include data specific to each of the DNOs, where required. Later this year we also intend to publish a draft framework for the RIGs.

1.25. We will then hold a statutory consultation in relation to the statutory instrument (regulations) in January next year and a statutory licence consultation in February next year. We plan to publish final RIGs along with the associated spreadsheets setting out the reporting requirements at a similar time, in February 2010, so that DNOs can review their reporting obligations at the same time as reviewing the proposed licence drafting changes for DPCR5 as set out in the statutory consultation.

⁴ There are a number of DPCR5 related working groups that deal with a broad spectrum of the environment, customers, networks and financial issues.

2. Proposed changes to licence conditions and other instruments to implement key DPCR5 policy issues

Chapter Summary

This chapter contains a summary of the changes we propose to make to standard and special licence conditions to implement key DPCR5 policy issues. We also provide an overview of the changes we propose to make to the Electricity (Standards of Performance) Regulations 2005, as well as an overview of the new Electricity (Connection Standards of Performance) Regulations we propose to introduce. We also explain our proposed changes to the Regulatory and Instructions Guidance (RIGs).

Question 1: Do you think any of our proposed changes to the standard licence conditions or new charge restriction conditions (current special licence conditions) are inappropriate?

Question 2: Do you think there are any other changes to the standard licence conditions or new charge restriction conditions (current special licence conditions) we should be looking to make at the start of the DPCR5 period?

Question 3: Do you think we have chosen the appropriate implementation instrument (e.g. licence condition, statutory instrument, RIG or direction) for each of the policy areas?

Structure of this chapter

2.1. In this chapter we summarise the changes we propose to make to licence conditions, regulations and RIGs to implement key DPCR5 policy issues. It is not an exhaustive summary of all changes that will be made to implement DPCR5.

2.2. We have categorised the proposed changes in this chapter under the following four headings for ease of reference:

- Customers,
- Environment,
- Networks,
- Connections.

2.3. Other changes that do not fall neatly within one of the above four headings are dealt with at the end of this chapter under the heading "Other".

Overview of the changes to the licence conditions

2.4. Our initial drafting of the licence conditions for DPCR5 is set out in Appendices 7 and 8 to this document. As noted in Chapter 1 of this document, our drafting is work in progress and subject to change.

2.5. We have sought to ensure clarity in our legal drafting to provide as much regulatory certainty as possible for the DNOs. However, at times it may be appropriate to strike a balance between a high degree of clarity and the need to ensure the legal drafting does not overly restrict our flexibility as a regulator to the cost of DNOs or customers.

2.6. We note that a number of instruments are available to Ofgem to implement DPCR5 policy - licence conditions, RIGs, directions and statutory instruments. In the course of the preparation of the legal drafting, we have carefully considered the appropriateness of each of these instruments. This is an area which we will keep under review as our DPCR5 legal drafting develops. We welcome comments from interested parties on this matter.

Current special licence conditions / new charge restriction conditions

2.7. We have to modify the special licence conditions at each price control review as these conditions need to reflect the level of revenues that a DNO may recover during the review period. For the reasons set out above (paragraphs 1.9 - 1.12), we also propose to restructure and renumber the special licence conditions for DPCR5. We will also rename them charge restriction conditions or CRCs to better reflect their purpose.

2.8. We propose to begin each CRC with one or more explanatory paragraphs summarising the purpose of the condition. This is in line with the conclusions of the DLR last year that the standard licence conditions should be restructured.

2.9. We have provided references to both current and new numbering of the special licence conditions/CRCs in this chapter.

Customers

2.10. We discuss below our proposed licence drafting approach for each of the key policy areas relating to improving customer service. The proposed drafting is based on our DPCR5 proposals set out in paragraphs 2.22, 2.23 and 2.27 of the Initial Proposals document. Further detail is also contained in Chapters 11 – 15 of the Initial Proposals – Incentives and Obligations document.

Quality of Service and Broad Measure of Customer Satisfaction (current special licence condition C2 / new CRC 9)

2.11. The Quality of Service licence condition sets out the legal framework for the following quality of service elements:

- Customer interruptions (CIs),
- Customer minutes lost (CMLs),
- Telephone response,
- Broad measure of customer satisfaction,
- Severe weather guaranteed standards of performance payments, and
- Normal weather guaranteed standards of performance payments.

2.12. There is currently a special licence condition in place covering all of the above elements of quality of service, except the broad measure of customer satisfaction which is a new incentive we propose to introduce for DPCR5. The key changes we propose to make to the current condition are to provide greater clarity and to improve the structure of the condition. We also propose to take a previously unused term and insert appropriate references to the broad measure of customer satisfaction.

2.13. We also propose to provide greater clarity on when a severe weather exceptional event starts and ends, and to broaden the types of one-off exceptional events that an examiner can review.

Non-connections guaranteed standards of performance (statutory instrument)

2.14. We are updating the existing statutory instrument (Electricity (Standards of Performance) Regulations 2005 (SI 2005 No 1019)) to reflect the introduction of a new and separate statutory instrument covering all connections related guaranteed standards of performance (see paragraphs 2.45 and 2.46 below). As well as removing the connections related standards from this statutory instrument we also intend to remove the redundant supply related standards and make a number of changes to improve clarity regarding when advanced notice of supply interruption is required and how rota disconnections fit within the standards framework. At this stage we have not made changes to the normal weather standard for one-off exceptional events as we are still evaluating the policy options given the responses to Initial Proposals. The policy options we put forward in our Initial Proposals were:

- Introduce a cap per customer for large one-off events equivalent to that applying for severe weather events,
- Introduce a limit on DNO exposure to individual one-off events,
- Introduce a limit on DNO exposure on a cumulative annual basis,

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- Update the payment levels for inflation, and
 - Correct an error on the level of payments under the planned interruption standards for business customers.

Environment

DG Incentive (current special licence condition D2 / new CRC 12)

2.15. Our proposal in relation to the distributed generation (DG) incentive framework is set out in paragraphs 2.6 and 2.9 of our Initial Proposals document and in more detail in Chapter 3 of our DPCR5 Initial Proposals - Incentives and Obligations document.

2.16. To implement our proposal we need to make changes to the current DPCR4 DG incentive. As set out in our Initial Proposals, the majority of elements within the DG incentive framework will remain unchanged for DPCR5. Nevertheless, certain modifications to current special licence condition D2 are required as follows:

- Change the DG incentive value to the new DPCR5 value of £1,000/MW/year. This is based on use of system connection assets only,
- Remove the special case applicable to Scottish and Southern Energy (SSE)⁵ and apply the new DPCR5 value to all DNOs,
- Change the definition of relevant DG (i.e. DG included within the DG incentive framework) to refer only to DG connecting from 1 April 2010 (instead of 1 April 2005 as was the case with DPCR4),
- Reset the 15 year incentivised period to be based on DPCR5,
- Modify the pass through formula to consider only use of system connection assets (thereby removing the DPCR4 work-around using shared connection capex (or gpc)). The definition of the term "gpc" should be removed as a result as it is not used elsewhere in the condition,
- Include cap and floor values for DPCR4, and
- Clarify elements relating to registered power zones (RPZ). This should involve ensuring all RPZ definition elements appear in the definitions in CRC 12.17 – 12.18 and clarifying that the RPZ incentive is applicable for five years (which was stated in the DPCR4 Final Proposals document⁶ but not written into the licence).

⁵ In particular, Scottish Hydro Electric Power Distribution Plc.

⁶ DPCR4 Final Proposals, November 2004 (Ref. 265/04)

2.17. The changes listed above will also require changes to the reporting requirements under the current RIGs applicable to DG. Those RIGs will be incorporated in the new RIGs structure.

Innovation Funding Incentive (IFI) (current special licence condition C3 / new CRC 11)

2.18. The IFI from DPCR4 will be retained for DPCR5 although certain changes will be required as indicated in Appendix 18 of our Initial Proposals - Incentives and Obligations document. Those changes are to:

- Remove the “start up” conditions for dealing with amounts incurred pre-2005, and
- Change the pass through factor to 0.8 across the total DPCR5 period.

2.19. In a change from our position set out in our Initial Proposals, we also propose to remove the limit on IFI internal company expenditure that qualifies as eligible IFI expenditure. In our Initial Proposals we indicated that there would be a limit of 15 per cent, unless otherwise consented to by Ofgem. However, on reflection and following input from the DNOs, we have now agreed that this clause is no longer necessary, as we had already indicated our willingness to grant consents.

2.20. The changes listed above will also require changes to the reporting requirements under the current RIGs applicable to IFI. Those RIGs will be incorporated in the new RIGs structure.

Business Carbon Footprint (BCF) (new SLC 46A)

2.21. We propose to create a new standard licence condition requiring the DNOs to report their business carbon footprints on an annual basis. This condition will be in Chapter 12 of the standard licence conditions concerning the provision of regulatory information and will have a similar format and structure to the existing conditions in that chapter.

2.22. Further detail on our BCF proposal can be found in Chapter 8 and Appendix 5 of our Initial Proposals - Incentives and Obligations document.

<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR4/Documents1/8944-26504.pdf>

2.23. The key element of the BCF condition will be that the DNOs must report annually on their BCF, according to new requirements set out in RIGs relating to BCF. We will need to incorporate these requirements in the new RIGs structure.

Transmission Connection Point Charges Incentive (new SLC 45A, current special licence condition B3 / new CRC 5 and new CRC 10)

2.24. In our Initial Proposals we explained our intention to introduce an incentive scheme for transmission connection point charges. Such an incentive scheme did not exist under DPCR4. Further detail on this proposal is available at Chapter 5 of our Initial Proposals - Incentives and Obligations document, paragraph 1.20 of our DPCR5 September Update and paragraphs 1.28 - 1.31 of Appendix 2 to that update document.

2.25. We propose a number of changes to give effect to this proposal:

- A new standard licence condition will be introduced in Chapter 12 of the standard licence conditions and will require DNOs to report on transmission connection point charges on an annual basis,
- Current special licence condition B3 / new CRC 5 will have to be amended to include this scheme in the total revenue adjustment to the demand use of system charges, and
- A new special licence condition or CRC (CRC 10) will have to be introduced to set out how the incentive scheme will operate and costs will be reflected on the DNOs. That condition will detail:
 - The mechanism for passing through the non-incentivised element of transmission connection point charges,
 - The allowances for the incentivised element, and
 - The formula for the operation of the incentive scheme (i.e. the sharing of the over/under performance).

2.26. New reporting requirements in relation to the transmission connection point charges incentive scheme will have to be included in the new RIGs structure.

DG Connections Guide and Information Strategy (new SLC 25A)

2.27. We propose to introduce a new standard licence condition to implement our proposal to improve the information DNOs provide to DG customers seeking a connection to the network (see paragraph 2.7 of Initial Proposals and Chapter 2 of Initial Proposals - Incentives and Obligations). We propose the new licence condition will have two essential elements:

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- A new requirement on DNOs to make public guidance that will assist potential DG customers in understanding and evaluating the process for connection (the DG connections guide). That guide must be tailored to the different customer groups. The form and content of the guide must be approved by the Authority and DNOs will be required to work collectively to prepare it, and
 - A new requirement on each DNO to provide to the Authority for approval a strategy on how it intends to provide information to DG customers (DG information strategy). That strategy must describe the DNO's plan for providing information to all DG customers, including actions and tools for this purpose. It should also explain how the DNO's strategy will be tailored for different types of load and customer, including justification for any differences in treatment and an indication of any differences in timescales depending on the load and customer.

Low Carbon Networks fund (LCN fund) (current special licence condition B3 / new CRC 5 and new CRC 14)

2.28. We propose to introduce a new special licence condition / CRC to implement our proposal for a LCN fund (see paragraphs 2.15 - 2.19 of our Initial Proposals document and Chapter 1 and Appendix 6 of Initial Proposals - Incentives and Obligations).

2.29. The LCN fund comprises three separate elements: Tier 1 funding, Tier 2 funding, and the Reward which are funded and managed differently.

2.30. Changes are required to licence conditions to give effect to the LCN fund as follows:

- Current special licence condition B3 / new CRC 5 will have to be amended to include a term reflecting the LCN fund amount in the incentive revenue adjustment (although it should be noted that this amendment is not reflected in the current licence drafting in Appendix 8 to this document and will be developed in due course), and
- A new special licence condition or CRC (CRC 14) will be introduced to calculate the LCN fund adjustment as the sum of the three elements: Tier 1, Tier 2 and the Reward. The new condition will also describe the LCN Fund Governance Document which will govern the operation and management of the LCN fund.

2.31. The Tier 1 element refers to a DNO's ability to spend up to its annual allowance (to be stated in a table in an annex to the relevant condition) on approved, eligible projects. A DNO will be allowed to pass through 90 per cent of this expenditure spread over five years and to receive a return on this expenditure.

2.32. The Tier 2 funding and the Reward elements will normally be set at zero. The Authority will be able to direct where appropriate that they take a value contained in the direction. The direction will also require that the DNO pays the amount collected

in the allowed revenue to another, specified DNO (that will be the DNO implementing the LCN fund project) and will provide details and restrictions to this end.

Losses

2.33. Under DPCR5, we propose to keep the losses incentive scheme but to bring about certain improvements to it to address the weaknesses we identified in our Initial Proposals. Our proposals in that regard and reasons for the changes are set out in paragraphs 2.11 - 2.14 of Initial Proposals and Chapter 6 of Initial Proposals - Incentives and Obligations.

2.34. We propose to make certain modifications to current special licence condition C1 / new CRC 8 to reflect our Initial Proposals and they are as follows:

- Amend the formula calculating the losses incentive adjustment to provide for a two year reporting lag. This will be done by referring to year t-2 rather than to year t,
- Amend the formula calculating the losses incentive adjustment to introduce a cap and floor,
- Change the value of the losses incentive amount to £60/MWh, and
- Require that the licensee calculates losses in accordance with a compliance statement approved by the Authority.

2.35. Following our Initial Proposals we are minded to calculate the losses targets during DPCR5 in order to use final settlements data. The condition will therefore be amended to remove the existing table of target percentages and to add a formula describing how the targets will be calculated, along with appropriate adjustments.

2.36. In our Initial Proposals we proposed to remove the existing adjustment for distributed generation that caused adverse losses. However, we are now minded to add this adjustment back into the losses calculation.

2.37. We will introduce a new standard licence condition (SLC 44B) to set out the high-level reporting requirements on licensees that are necessary to support the losses incentive scheme. The reporting requirements in SLC 44B will be set out in more detail in a RIG document.

2.38. In summary, SLC 44B and the proposed RIG content will:

- Introduce reporting requirements that require the licensee to measure, record and annually report information that relates to the energy entering and exiting the licensee's distribution system,

-
- Set out in detail what information the licensee must measure, record and report and how it should collate that information, and
 - Introduce a requirement on the licensee to provide a statement of compliance.

Networks

2.39. As network output measures are a new feature of the regulatory regime for DPCR5 there are not any existing licence conditions or obligations of relevance. There are three key elements to the development of the legal framework for network outputs as follows:

- A new standard licence condition,
- A new set of reporting requirements within the new RIGs structure (see paragraphs 2.57 – 2.62 below), and
- A means to capture the financial consequences for a DNO who under-performs against network outputs agreed as part of the DPCR5 settlement.

2.40. Our proposal in relation to network output measures is set out in paragraphs 2.41 – 2.46 of our Initial Proposals and Chapter 17 of our Initial Proposals – Incentives and Obligations document.

Standard Licence Condition – Network Outputs Reporting Regime (new SLC 44A)

2.41. We propose to introduce a new standard licence condition specific to network outputs. The licence condition will require DNOs to:

- As part of the DPCR5 settlement, commit to a set of network outputs under the agreed common methodology,
- Report annually on performance against the agreed network outputs in accordance with specified timeframes and the instructions and guidance contained in the new network asset data and performance reporting RIGs which are under development, and
- Provide access to an examiner to inspect the systems, processes and procedures in place to capture network outputs data.

New RIGs requirements

2.42. The new RIGs structure (specifically the Network asset data and performance reporting RIGs) will detail the annual reporting requirements for network outputs, as required by the new standard licence condition. These new RIGs requirements are currently under development via the Network Outputs Working Group (NOWG) – a

technical committee comprising Ofgem and the 14 DNOs. Once fully developed, the RIGs will contain:

- A statement on the objectives of the network outputs reporting regime, and a description of how in practice its requirements will contribute to the achievement of those objectives,
- A description of the agreed common methodology for reporting network outputs, definitions of key terms, and a series of spreadsheet templates with detailed guidance,
- Details of the commentary to be provided by DNOs to accompany their annual data submission, which will include commentary on the changes that take place over DPCR5 which impact outturn performance against the agreed network outputs, and
- A description of the process that will be followed and the information that will be taken into account by Ofgem in determining whether a DNO has performed satisfactorily against its agreed network outputs.

Financial consequences for under-performance

2.43. At DPCR6, for a DNO whom Ofgem determines has not performed satisfactorily against the agreed network outputs there is likely to be some penalty mechanism developed in time for Final Proposals. The options for capturing the consequences in the legal framework include:

- A new special licence condition / CRC, or
- A detailed description in the Final Proposals document of the policy and how it will operate in practice.

2.44. Given that there will not be a mechanistic relationship between revenues and network outputs performance, we do not consider a new special licence condition / CRC to be an appropriate mechanism. On this basis we propose to set out our approach to this issue in the Final Proposals document. Following discussion at the LDWG, the DNOs have indicated their support for this approach to implementation.

Connections

Connection standards of performance

2.45. As set out in our Initial Proposals (see paragraph 2.23, as well as Chapter 10 (especially paragraphs 10.14 – 10.33) of our Initial Proposals – Incentives and Obligations document), we propose to extend regulation and protection for customers who choose to source connections from their DNO. We have been developing our proposals for connections related guaranteed standards of

performance (applicable to metered and unmetered connections) through Ofgem's Electricity Connections Steering Group (ECSG). Through the ECSG we have worked closely with DNOs, IDNOs/independent connection providers (ICPs), customers and other interested parties.

2.46. The main elements of this proposal are as follows:

- A new statutory instrument (Electricity (Connection Standards of Performance) Regulations) which will set out the new connection guaranteed standards. A draft of the statutory instrument is still being developed and interested parties will be invited to comment on it shortly,
- A new standard licence condition (SLC 15A) which will support the statutory instrument. A draft of this licence condition is contained in Appendix 7 to this document. The three key elements of SLC 15A will be as follows:
 - The introduction of new RIGs requirements that will detail the reporting arrangements to support the new connection standards of performance,
 - The introduction of a 90% performance target that will apply to these standards. The exact application of this target is still being developed by the relevant ECSG working group and will be reflected in a subsequent draft of SLC 15A within the second licence drafting consultation document later this year, and
 - The introduction of a price accuracy review scheme. While we continue to develop our policy in this area, we anticipate the introduction of a requirement on licensees to submit to the Authority for its agreement a price accuracy review scheme. Through this scheme customers will be able to require the licensee to review the accuracy of quotations for obtaining a new electricity connection or altering an existing electricity connection. In the event that the licensee provides an inaccurate quotation, the licensee may be required to adjust any charges made to the customer to the amount due under an accurate quotation,
- Amendments to SLC 15 (and possibly SLCs 12 and 14) as a consequence of the proposal outlined above, and
- New reporting requirements in relation to the new connections related guaranteed standards of performance will have to be introduced in the new RIGs structure.

Competition in connections (new CRC 13)

2.47. For DPCR5 we are introducing a new policy for connections (see paragraphs 2.25 – 2.26 of our Initial Proposals and Chapter 10 (in particular paragraphs 10.34 – 10.48) of our Initial Proposals – Incentives and Obligations document). One strand of this policy allows DNOs to charge a regulated margin on the contestable element of fully funded connections once they have verified they have systems and processes

in place to comply with the Electricity (Connection Standards of Performance) Regulations and the relevant RIGs requirements we propose to introduce. The key elements for this strand of the policy are:

- A set of legal tests that must be met,
- Segmentation of the connections market (we propose to introduce segmentation to identify segments where competition is more likely to develop and which in turn would attract a connection margin), and
- A competition test that must be passed in order to be able to move to unregulated margins.

2.48. Where connections are fully funded by customers DNOs will be able to charge a regulated margin on both the direct and indirect contestable elements until there is effective competition in their area. If the DNO can demonstrate to the Authority that competition has developed it will be allowed to charge an unregulated margin on both the direct and indirect contestable elements.

2.49. Where a DNO is charging an unregulated margin and subsequently is found to be in breach of its licence obligations or the Competition Act 1998, the condition will enable the clawback of a proportion of the unregulated margin.

2.50. The condition provides for DNOs to submit an evidence case across all market segments or in a particular segment from 1 April 2010 up until 31 December 2013.

Other

Demand and generation revenue pots (current special licence conditions B1 and D1 / new CRCs 3 and 6)

2.51. Currently there are restrictions on the portion of allowed revenues each DNO can recover from demand and generation customers. These restrictions were put in place because at the start of DPCR4 Ofgem was not satisfied that the DNO charging methodologies would result in an appropriate recovery of allowed revenues across these two categories of customers. The restrictions are set out in special licence conditions B1 and D1. The generation revenue pot recovers revenue from the generation pass through, the generation incentive and related operation and maintenance allowance from generators who connected post April 2005.

2.52. We propose to change these special licence conditions to allow the DNO to request the Authority's consent that a DNO can apply a single revenue pot, where this appears appropriate. We do not consider that a blanket allowance of a single pot across all DNOs and across all voltage levels is appropriate from April 2010, however, as the required charging arrangements for generation will not be in place in all DNOs' licences until after that date. The implementation of a single revenue pot is likely to occur over time as explained in paragraphs 2.53 and 2.54 below.

2.53. The DNOs have brought forward – for anticipated implementation from 1 April 2010 - common charging arrangements in relation to the lower voltage levels (HV and LV) on which we are currently consulting⁷. The DNOs propose one revenue pot for lower voltage customers, and for more cost reflective generation charges to apply to all generators connected at lower voltages. For this proposal to be implemented would require a change to special licence conditions B1 and D1 to allow demand and generation revenue pots to be merged for lower voltage charges. Our current view is that this appears appropriate at lower voltages, but we will consider responses to our other consultation on the DNOs' common methodology before deciding finally on any licence amendment. Under the proposed arrangements the DNOs would need to request consent for this one pot approach at HV/LV to take effect.

2.54. The new generation charging arrangements at higher voltages (EHV) are not anticipated to take effect until April 2011 (with the exception of Western Power Distribution which has had new charging arrangements in place since April 2007). As this development must take place before a single revenue pot can be applied across all voltage levels, we consider we cannot implement a single revenue pot for the start of DPCR5. We anticipate, however, that we will be able to consider requests by DNOs to merge their revenue pots at the higher voltages on a case by case basis during the DPCR5 period.

Managing cost and volume uncertainty

2.55. As set out in the Initial Proposals document (paragraphs 4.13 – 4.19) and more recently our September Update to Initial Proposals, we have identified a number of areas where there exists significant uncertainty about the costs the DNOs will face over the DPCR5 period. In these documents we have set out our proposals to include reopeners for the following four categories of costs: traffic management permitting, load related expenditure, logged up expenditure items, and rising and lateral mains.

2.56. These reopeners will be implemented through a combination of licence modification (to special licence condition A3 / new CRC 19) and guidance in the Final Proposals document.

Regulatory and Instructions Guidance (RIGs)

2.57. Ofgem places reporting requirements on the DNOs to enable us to monitor their performance against their price control obligations. The RIGs set out

⁷ Electricity distribution structure of charges project: DNOs' proposals for a common methodology at lower voltages, 28 September 2009 (Ref. 114/09)
http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/Ofgem_CDCM_consultation%20280909_1.pdf

instructions and guidance for the DNOs on how to complete these reporting requirements.

2.58. There are currently four separate RIGs documents for: cost reporting, revenue reporting, quality of service, distributed generation incentive, innovation funding incentive, and registered power zones. As a result of our proposals for DPCR5 there is the potential for the number of RIGs documents to increase as data on environmental and network related issues, for example, is captured. The DNOs have raised a concern that this could make reporting unwieldy and could potentially lead to duplication in the information that they are required to provide.

2.59. In light of this we have agreed to work with the DNOs to review the reporting requirements under DPCR5. Our preliminary view is that the following groupings of reporting obligations is appropriate:

- Cost and revenue reporting - which would include all data of a financial nature and would essentially combine the current cost and revenue reporting obligations. It would also include, for example, the incentive revenue associated with our environmental proposals,
- Network asset data and performance reporting - which would include data associated with the physical network, CIs and CMLs, volumes of connections, etc. It would also include, for example, the output related data associated with our environmental proposals, including the BCF, and
- Customer service reporting - which would include the customer related standards and measures.

2.60. We are also undertaking a holistic review of the reporting requirements to ensure that there is no duplication or gaps in the information that we are asking for.

2.61. We would also draw to interested parties' attention our intention to include within the new RIGs structure new reporting requirements on the DNOs obliging them to provide details of the number and types of apprentices they are training and other forms of workforce renewal. These new requirements come out of our assessment of the appropriate level of workforce renewal costs for each of the DNOs during DPCR5 (part of our work to determine our cost baselines) and will be developed in consultation with EU Skills.

2.62. In addition, we are reviewing how we can disseminate this information to interested parties, and particularly to customers, effectively. As part of this work we are seeking the views of the Consumer Challenge Group, (a group set up by Ofgem to provide a consumer view on the DPCR5 proposals) and other stakeholders on what information consumers find particularly useful.

Appendices

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. In particular, we would like to hear from interested parties, other than DNOs, i.e. consumers and their representatives, IDNOs, owners and operators of distributed generation schemes, transmission owners, generators, electricity suppliers, the Department of the Environment and Climate Change (DECC) and any other interested parties.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 17 November 2009 and should be sent to:

DPCR5 Response
Distribution

Ofgem
2nd floor
9 Millbank
London
SW1P 3GE

020 7901 7026
DPCR5.reply@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to:

John Wilson
Senior Legal Adviser, Distribution

9 Millbank, London, SW1P 3GE
020 7901 7226

john.wilson@ofgem.gov.uk

CHAPTER: One

Question 1: Do you think our proposed timetable for the implementation of changes to the licence conditions and other legal instruments (set out in this chapter) is appropriate?

CHAPTER: Two

Question 1: Do you think any of our proposed changes to the standard licence conditions or new charge restriction conditions (current special licence conditions) are inappropriate?

Question 2: Do you think there are any other changes to the standard licence conditions or new charge restriction conditions (current special licence conditions) we should be looking to make at the start of the DPCR5 period?

Question 3: Do you think we have chosen the appropriate implementation instrument (e.g. licence condition, statutory instrument, RIG or direction) for each of the policy areas?

Appendix 2 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority’s powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.⁸

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly.⁹

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them;¹⁰
- the need to contribute to the achievement of sustainable development; and

⁸ Entitled “Gas Supply” and “Electricity Supply” respectively.

⁹ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

¹⁰ Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

-
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.¹¹

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed¹² under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation¹³ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

¹¹ The Authority may have regard to other descriptions of consumers.

¹² Or persons authorised by exemptions to carry on any activity.

¹³ Council Regulation (EC) 1/2003.

Appendix 3 - Glossary

123

132 kV

Only covers assets at the 132 kV voltage level.

ABC

B

Business Carbon Footprint (BCF)

Total set of greenhouse gas emissions caused directly and indirectly by the operation of a business.

C

Capital Expenditure (Capex)

Expenditure on investment in long-lived distribution assets, such as underground cables, overhead electricity lines and substations.

Critical national infrastructure (CNI)

Sites vital to the normal operation of the network, taking account of Home Office and MI5 Protection of Critical National Infrastructure (PCNI) guidance.

Customer interruptions (CIs)

The number of customers whose supplies have been interrupted per 100 customers per year over all incidents, where an interruption of supply lasts for three minutes or longer, excluding re-interruptions to the supply of customers previously interrupted during the same incident. It is calculated as:

$$\frac{\text{The sum of the number of customers interrupted for all incidents} * 100}{\text{The total number of customers}}$$

Customer minutes lost (CMLs)

The duration of interruptions to supply per year – average customer minutes lost per customer per year, where an interruption of supply to customer(s) lasts for three minutes or longer, calculated as:

$$\frac{\text{The sum of the customer minutes lost for all restoration stages for all incidents}}{\text{The total number of customers}}$$

D[Department of Energy and Climate Change \(DECC\)](#)[Distributed Generation \(DG\)](#)

Any generation which is connected directly into the local distribution network, as opposed to the transmission network, as well as combined heat and power schemes of any scale. The electricity generated by such schemes is typically used in the local system rather than being transported for use across the UK.

[Distributed Generation Incentive \(DGI\)](#)

The DG incentive is a 'hybrid' incentive scheme that provides for partial pass-through treatment of reinforcement costs incurred in providing network access to DG and a £/kW revenue driver to incentivise connection of DG. The 'hybrid' incentive sought to combine incentives for efficiency (via the incentive rate) with protection against cost uncertainty (via the cost pass through). An additional element to the incentive was created to provide ongoing network access (availability). The allowances were set based on the DNOs' expectations of likely DG connections and the costs associated with those connections.

[Distribution Network Operators \(DNOs\)](#)

A DNO is a company which operates the electricity distribution network which includes all parts of the network from 132kV down to 230V in England and Wales. In Scotland 132kV is considered to be a part of transmission rather than distribution so their operation is not included in the DNOs' activities.

There are 14 DNOs in the UK which are owned by seven different groups as follows: CE Electric UK, Central Networks, EDF Energy Networks, Electricity North West, Scottish Power, Scottish and Southern Energy and Western Power Distribution.

[Distribution Price Control Review 4 \(DPCR4\)](#)

Distribution price control review 4. This price control runs from 1 April 2005 and is expected to run until 31 March 2010.

[Distribution Price Control Review 5 \(DPCR5\)](#)

Distribution price control review 5. This price control is expected to run from 1 April 2010 until 31 March 2015.

E[Energy and Utility Skills \(EU Skills\)](#)

EU Skills is the Sector Skills Council for the gas, power, waste management and water industries.

[Extra High Voltage \(EHV\)](#)

Includes all voltage levels above 20kV up to but excluding 132kV.

[Electricity Networks Strategy Group \(ENSG\)](#)

[Electricity Connections Steering Group \(ECSG\)](#)

H

[High Voltage \(HV\)](#)

Includes all voltage levels above 1kV up to and including 20kV.

I

[Independent connections provider \(ICP\)](#)

[Independent distribution network operators \(IDNOs\)](#)

Any electricity distributor whose licence was granted after 1 October 2001. IDNOs do not have distribution services areas.

[Innovation Funding Incentive \(IFI\)](#)

The IFI is intended to encourage DNOs to invest in appropriate research and development activities that are designed to enhance the technical development of distribution networks (up to and including 132 kV) and to deliver value (i.e. financial, supply quality, environmental, safety) to end consumers.

[Interruptions Incentive Scheme \(IIS\)](#)

On 1 April 2005 Ofgem introduced a revised interruptions incentive scheme which provides financial incentives to DNOs with respect to the average quality of service they provide in terms of:

- the number of interruptions to supply, and
- the duration of interruptions to supply.

DNOs may be rewarded or penalised by up to 3 per cent of revenue, depending on performance relative to their interruptions targets in each year of the scheme.

[Information Quality Incentive \(IQI\)](#)

The IQI is a mechanism for setting price control allowances that provides ex ante incentives for DNOs to submit accurate forecasts of their expected expenditure and provides incentives for efficiency improvements once the price control has been set.

K**Kilowatt (KW)**

A measure of energy equal to one thousand watts.

L**Legal drafting working group (LDWG)**

A working group established and chaired by Ofgem which comprises representatives from Ofgem and the DNOs. The purpose of the legal drafting working group is to provide a peer review function to Ofgem. In particular, the group will be responsible for reviewing Ofgem's development of all proposed changes to licence conditions, as well as the SIs and the RIGs.

Low carbon networks fund (LCN fund)

Funding to encourage the DNOs to innovate to deliver the networks we will need for a low carbon economy.

Low Voltage (LV)

All voltage levels up to and including 1kV.

M**Megawatt (MW)**

A measure of energy equal to one thousand Kilowatts.

N**Network Outputs Working Group (NOWG)****Q****Quality of service (QoS)****R****Registered Power Zone (RPZ)**

RPZ is a mechanism to encourage DNOs to develop and demonstrate new and more cost effective technologies for connecting and operating generation on their distribution systems.

Regulatory and Instructions Guidance (RIGs)

The RIGs set out definitions and related instructions and guidance for collating and

reporting information.

S

Scottish and Southern Energy (SSE)

Scottish Hydro Electric Power Distribution plc (SHEPD)

Appendix 4 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk

Appendix 5 – Overview of proposed changes to licence conditions and other instruments to implement DPCR5 policy

This appendix is intended to provide interested parties with an overview of the licence conditions and other instruments likely to be affected by the implementation of DPCR5 policy. It sets out changes including and in addition to those changes discussed in Chapter 2 of this consultation document. The proposed changes are divided into six categories for the purpose of this appendix as follows:

1. Customers
2. Environment
3. Networks and network outputs
4. Connections
5. Financial
6. Price control cost and revenue reporting

Policy Title	Summary of policy objectives	Proposed changes to licence conditions and other instruments
1. Customers		
Information and incentives scheme (IIS)	To incentivise DNOs to reduce customer interruptions and customer minutes lost where economic to do so.	Amendments to special licence condition C2 / new CRC 9. Revisions to Quality of Service (QoS) RIGs version 5, to appear in relevant RIGs in new RIGs structure.
Telephony (customer contact following power loss)	To measure customer satisfaction with the call handler's response to their contact following power loss.	Amendments to special licence condition C2 / new CRC 9. Revisions to QoS RIGs version 5, to appear in relevant RIGs in new RIGs structure.
Broad Measure of customer satisfaction	Broaden our customer satisfaction measure for DPCR5 to better capture the full range of interactions that customers have with DNOs.	New CRC 9 Completely new area of RIGs to be included in relevant RIGs in new RIGs structure.
Guaranteed standards of performance	Revisions to payment levels to reflect inflation since first introduced.	Amend existing Electricity (Standards of Performance) Regulations

Policy Title	Summary of policy objectives	Proposed changes to licence conditions and other instruments
	Clarifications to normal and multiple interruptions standards.	2005 (SI 2005 No 1019). Issue revised guidance document/include in relevant RIGs in new RIGs structure.
2. Environment		
Fluid filled cables (FFC)	To monitor DNOs' risk-based management of their FFC portfolio, balancing environmental risks and network operation and maintenance.	Amend relevant RIGs in new RIGs structure.
Business carbon footprint (BCF)	To provide reputational incentive for DNOs to manage and reduce their operational carbon emissions other than losses.	Introduce new standard licence condition (SLC) – SLC 46A. New elements to be introduced in the relevant RIGs (similar in form to the BCF Appendix, Appendix 5, in the Initial Proposals – Incentives and Obligations document).
Distributed generation (DG) incentive	To retain the existing DG incentive with minor amendments.	Minor amendments required to relevant licence conditions – SLC 46 and special licence condition D2 / new CRC 12. Update RIG relating to DG/registered power zone (RPZ)/innovation funding incentive (IFI) and incorporate in new RIGs structure.
DG information	To set a package of obligations that ensure DNOs are proactive in making information available to current and potential DG customers, facilitate the connection process and provide a satisfactory level of service to customers requesting	Issue direction under SLC 25 to amend the form of the Long-Term Development Statement (LTDS). Introduce new standard licence condition (SLC 25A) requiring DNOs to: - work together to

Policy Title	Summary of policy objectives	Proposed changes to licence conditions and other instruments
	connections.	<p>prepare guidance for potential DG customers wishing a connection (DG connections guide), and</p> <ul style="list-style-type: none"> - submit individually for the Authority's approval a strategy for information provision to DG customers (DG information strategy).
Transmission connection point charges	To incentivise DNOs to manage (a subset of) transmission exit charges.	<p>Introduce a new standard licence condition (SLC 45A) that will require the reporting of transmission connection point charges on an annual basis.</p> <p>Introduce a new special licence condition (new CRC 10) that will set out how the incentive scheme will operate.</p> <p>Amend existing price control Revenue Reporting RIGs and include in new RIGs structure.</p>
Innovation Funding Incentive (IFI)	To retain the IFI but with certain changes, including the discontinuation of the RPZ after DPCR4.	<p>Minor amendments to SLC 46, special licence condition D1 / new CRC 6 and special licence condition D2 / new CRC 12 to remove reference to RPZ.</p> <p>Minor amendment to special licence condition C3 / new CRC 11 to change the IFI pass through value.</p> <p>Update RIG relating to DG/RPZ/IFI and incorporate in new RIGs</p>

Policy Title	Summary of policy objectives	Proposed changes to licence conditions and other instruments
Low Carbon Networks fund (LCN fund)	To introduce a new innovation mechanism to allow DNOs to try out new technology and new commercial arrangements to see what arrangements will allow them to provide the best service that users will need in a low carbon economy.	structure. Minor amendment to current special licence condition B3 / new CRC 5. Introduce new special licence condition, CRC 14, which will contain the governance structure for the LCN fund.
Losses	To retain the losses incentive scheme but improve it to address identified weaknesses.	Amendments to special licence condition C1 / new CRC 8. Introduce new special licence condition, CRC 44B (distribution losses scheme). Amend existing price control Revenue Reporting RIGs and include in new RIGs structure.
3. Networks and network outputs		
Equalising incentives	To ensure that economic trade-offs are not distorted between capex and opex solutions. To ensure that non-network solutions compatible with tackling climate change (e.g. demand side management) are not discouraged. To avoid incentives for reclassifying costs (boundary issues). To simplify the current regulatory asset value (RAV) rules.	No effect on standard or special licence conditions.
Managing cost and volume uncertainty	To provide protection against risks which are outside the control of	Amend special licence condition A3 / new CRC 19 to include reopeners for

Policy Title	Summary of policy objectives	Proposed changes to licence conditions and other instruments
	<p>DNOs.</p> <p>To help avoid windfall gains and losses – the latter could result in financial distress.</p>	<p>permitting under the Traffic Management Act, load related expenditure, tax trigger and CNI costs, HILP, black start and emergency batteries, and possibly rising and lateral mains.</p> <p>Amend special licence condition B1 / new CRC 3.</p>
Data Services	<p>Possibly to consolidate the provisions concerning data services and metering point administration services to have one condition referring to all appropriate parties (e.g. referring to IDNOs as well as suppliers as appropriate) and contained in the section of the licence applicable to all distributors.</p> <p>To clarify cost and revenue reporting requirements.</p>	<p>Possibly to consolidate SLCs 17 and 35.</p> <p>Update reporting requirements in the Cost Reporting and Revenue Reporting RIGs and incorporate within the new RIGs structure.</p>
Excluded Services	<p>To revise the scope, definitions and price control treatment so that DNOs are appropriately remunerated for these services and motivated to respond to customer demand. In addition, to review the activities scheduled as excluded services so that over the medium to long term, synergies with core distribution activities can be realised.</p>	<p>Amend special licence condition A2 / new CRC 16.</p> <p>Update reporting requirements in the Cost Reporting and Revenue Reporting RIGs and incorporate within the new RIGs structure.</p>
Network Outputs Regime	<p>Collect information annually on outturn performance against agreed DPCR5 outputs, to ensure that customers</p>	<p>A new standard licence condition for the Network Outputs Reporting Regime will be required.</p>

Policy Title	Summary of policy objectives	Proposed changes to licence conditions and other instruments
	<p>receive value for the revenues provided to DNOs to undertake network investment.</p> <p>Provide opportunity for DNOs to explain outturn performance against output measures, and to allow for changed circumstances which impact on performance. The objective is to make DNOs accountable for their investment decisions, whilst ensuring that flexibility and innovation in asset management practices are not stifled.</p>	<p>The standard licence condition will refer to a new Network Outputs RIG (consolidated within the new RIGs structure).</p> <p>This will capture the new outputs reporting requirements, including a series of spreadsheet templates and detailed guidance for populating the templates.</p> <p>In addition, the RIGs will set out in detail the commentary to be provided by DNOs to accompany their annual data submission. This includes commentary on the changes that take place over DPCR5 which impact outturn performance against the Agreed Network Outputs.</p>
Audit of Network Outputs data	Audit to ensure quality and accuracy of output information provided.	As with the IIS, the draft standard licence condition for Network Outputs may include provisions which allow Ofgem to conduct an examination of the systems, processes and procedures to enable it to measure the information provided under the Network Outputs RIG.
Consequences for failure to meet the Agreed Network Outputs	<p>Ensure DNOs are accountable for their actual investment decisions taken over DPCR5, and seek to penalise a DNO whom Ofgem determines has not satisfactorily met its outputs.</p> <p>Recognising that changes</p>	<p>For under-performing DNOs there may be some mechanism developed to either clawback DPCR5 revenues ex post or DPCR6 revenues ex ante. We propose to set out a detailed description of this mechanism in the FP document. This will set out the policy and how it</p>

Policy Title	Summary of policy objectives	Proposed changes to licence conditions and other instruments
	over the period are inevitable, avoid putting in place a mechanistic relationship between output performance and revenues.	will operate.
4. Connections		
Connections standards of performance	To improve the level of service that customers receive from DNOs when requesting a connection. The scope of our changes is designed to introduce guaranteed standards for metered and unmetered connections, and provide for automatic compensation payments where these standards are breached by DNOs, as well as ensuring overall performance in the provision of connections.	Introduce new SLC 15A. Introduce new Electricity (Connection Standards of Performance) Regulations. Amendments to SLC 15 (and possibly SLCs 12 and 14) as a consequence of the connections proposal.
Connections – Price Accuracy Review Scheme	The scope of the change is to introduce a scheme through which small customers can challenge whether they have received accurate quotations. This will be agreed with the Authority and published by the DNOs. The regulations will then provide for automatic compensation payments for inaccurate quotations.	Cover in new SLC 15A and new Electricity (Connection Standards of Performance) Regulations. Amendments to SLC 15 (and possibly SLCs 12 and 14) as a consequence of the connections proposal.
Margins on connections	Allow a regulated margin on fully funded connections that are deemed to be “attractive to competition” for a period up to December 2013. DNOs able to come forward at any point up until then to prove their case and move to unregulated margins if	Introduce new special licence condition (new CRC 13). Completely new areas of connection related RIGs to be included in relevant RIGs in new RIGs structure.

Policy Title	Summary of policy objectives	Proposed changes to licence conditions and other instruments
	successful.	
5. Financial		
Demand and generation revenue pots	To allow the merging of demand and generation revenue pots once DNOs have cost reflective charges.	Amend special licence conditions B1 (new CRC 6) and D1 (new CRC 12).
6. Price control cost and revenue reporting		
Bad debt recording	To set out the information that should be compiled to support any logged up claim at DPCR6.	Update requirements in Cost Reporting RIGs within new RIGs structure.
Compliance with charge restrictions – audit requirements	To update the audit requirements to reflect the fact that audit procedures (AUPs) are AUPs confirmed by Ofgem and bring into line the description of the report with AUP standards.	Minor amendments to SLC 47.9 – 47.12.

Appendix 6 – Index of affected licence conditions

This appendix contains an index of all of the standard and special licence conditions that will be affected by the DPCR5 legal drafting process in the order in which they will appear in the licence.

STANDARD LICENCE CONDITIONS

Condition number	Condition title
1	Definitions for standard conditions
12	Requirement to offer terms for Use of System and connection
14	Charges for Use of System and connection
15	Standards for the provision of Non-Contestable Connection Services
NEW 15A	Connection policy and connection performance
NEW 25A	Distributed Generation Connections Guide and Information Strategy
NEW 44A	Network Outputs Regime
NEW 44B	Distribution Losses Regime
NEW 45A	Incentive scheme for Transmission Connection Point Charges
46	Incentive schemes for innovation funding and Distributed Generation
NEW 46A	Business Carbon Footprint Report
47	Reporting of Price Control Revenue Information
48	Reporting of Price Control Cost Information
49	Modification of RIGs in force under Chapter 12

SPECIAL LICENCE CONDITIONS

As explained in Chapters 1 and 2 of the consultation document the special licence conditions have been restructured and renumbered as part of a wider review, not directly related to DPCR5 proposals. The table below is intended to assist interested parties by showing how current special licence conditions will correspond to new charge restriction conditions (CRCs) as they will be referred to in the future. All of the special licence conditions will be affected in this restructure. Greyed out boxes indicate where there is no current similar special licence condition.

New condition number	New condition title	Current condition number	Current condition title
CRC 1	Overview of Part 4	N/A	N/A
CRC 2	Definitions for the Charge Restriction Conditions	A1	Definitions and interpretation
CRC 3	Restriction of Distribution Charges: Demand Use of System Charges	B1	Restriction of distribution charges: demand use of system charges
CRC 4	Restriction of Distribution Charges: calculation of	B2	Restriction of distribution charges: allowed pass-

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New condition number	New condition title	Current condition number	Current condition title
	the Allowed Pass-Through Items		through items
CRC 5	Restriction of Distribution Charges: total incentive revenue adjustment	B3	Restriction of distribution charges: total incentive revenue adjustment
CRC 6	Restriction of Distribution Charges: Generation Use of System Charges	D1	Restriction of distribution charges: generation use of system charges
CRC 7	Restriction of charges for the provision of Legacy Metering Equipment	F1	Restrictions of charges for legacy basic meter asset provision
CRC 8	Adjustment of licensee's revenues to reflect distribution losses performance	C1	Calculation of charge restriction adjustments arising from the distribution losses incentive scheme
CRC 9	Adjustment of licensee's revenues to reflect quality of service performance	C2	Calculation of charge restriction adjustments arising from performance in respect of quality of service
CRC 10	Adjustment of licensee's revenues to reflect performance in relation to Transmission Connection Point Charges	N/A	N/A
CRC 11	Adjustment of licensee's revenues to reflect innovation funding performance	C3	Calculation of charge restriction adjustments arising from the innovation funding incentive scheme
CRC 12	Adjustment of licensee's revenues to reflect performance in relation to Distributed Generation	D2	Calculation of charge restriction adjustments arising from the incentive schemes for distributed generation and registered power zones
CRC 13	Licensee's Connection Activities: Margins and the development of competition	N/A	N/A
CRC 14	Low Carbon Networks Fund	N/A	N/A
CRC 15	Distribution Charges: supplementary restrictions	E1	Charge restriction conditions: supplementary restrictions
CRC 16	Services treated as Excluded Services	A2	Scope of the charge restriction conditions
CRC 17	Charging outside the Distribution Services Area	G1	Restriction of distribution charges outside the distribution area

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New condition number	New condition title	Current condition number	Current condition title
CRC 18	Assistance for high-cost distribution areas	J	Assistance for high-cost distribution areas (applicable to Scottish Hydro Electric Power Distribution plc only)
CRC 19	Arrangements for the recovery of uncertain costs	A3	Arrangements for the recovery of uncertain costs
CRC 20	[Reconsideration of the Charge Restriction Conditions]	N/A	N/A
CRC 21	Duration of the Charge Restriction Conditions	A4	Duration of the charge restriction conditions