

Modification proposal:	Central Networks (East and West)¹ – Proposals concerning use of system charging methodology – implementation of CDCM (04/2009 East and 04/2009 West)		
Decision:	The Authority ² directs that this proposal is not vetoed ³		
Target audience:	DNOs, IDNOs, Suppliers, Generators and other interested parties		
Date of publication:	25 March 2010	Implementation Date:	1 April 2010

Background to the modification proposal

CN have licence obligations⁴ to have in place at all times three charging statements in relation to Use of System (UoS) and Connection: the Statement of UoS Charging Methodology, the Statement of UoS Charges and Statement of Connection Charging Methodology and Charges. The statement of UoS Charging Methodology outlines the method by which distribution UoS charges are calculated. CN has a requirement to keep the methodology under review and bring forward proposals to modify the methodology that they consider better achieve the relevant objectives⁵.

On 20 November 2009, the Authority conditionally approved the Common Distribution Charging Methodology (CDCM)⁶. The CDCM introduces a new methodology for calculating UoS charges for customers connected to Distribution Network Operators' (DNOs) low and high voltage (LV/HV) networks. The CDCM will take effect from 1 April 2010. To facilitate the implementation of the CDCM, DNOs are obliged by their licences to revoke their current LV/HV methodologies by 31 March 2010.

The Authority decided in its Distribution Price Control Review (DPCR5) Final Proposals⁷, published on 7 December 2009, that the calculation of individual revenue pots for calculating demand and generation Use of System charges should be replaced by the calculation of a single revenue pot to be recovered from all customers. The Authority also decided to lift a blanket exemption, that currently applies to all DNOs, from charging

¹ Central Networks own two electricity distribution licensees – Central Networks East and Central Networks West. This letter applies to both licensees.

² The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

³ This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

⁴ Standard licence conditions (SLC) 13 -14.

⁵ The relevant objectives for the UoS charging methodology, as contained in paragraph 3 of SLC 13 of CN's licences are:

- (a) that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence;
- (b) that compliance with the methodology facilitates competition in the 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 methodology results in changes which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its Distribution Business; and
- (d) that, so far as is consistent with sub-paragraphs (a), (b) and (c), the UoS charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's Distribution Business.

⁶ The Authority's decision document can be found at:

[http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/CDCM%20decision%20doc%20201109%20\(2\).pdf](http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/CDCM%20decision%20doc%20201109%20(2).pdf)

⁷ A copy of our Final Proposal is on our website. Please see

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=346&refer=Networks/ElecDist/PriceCntrl/DPCR5>

distributed generators (DG) for UoS. The exemption will expire from 31 March 2010. All DNOs have now accepted our Final Proposals in principle⁸.

As a consequence of the impending implementation of the CDCM and DPCR5 Final Proposals, we asked that each DNO review their extra-high-voltage (EHV) methodologies. DNOs are now bringing forward modifications to their existing EHV methodologies to ensure they better achieve the relevant objectives from 1 April 2010. We also asked DNOs that any necessary modifications, where possible, have a minimal impact on charges ahead of the implementation of the common EHV Distribution Charging Methodology (EDCM)⁹ from 1 April 2011.

Summary of CN's proposals

On 24 March 2010, CN submitted a modification report to the Authority setting out proposals to modify their UoS charging methodologies, which are intended to reflect changes in the industry – i.e. the impending implementation of the CDCM and DPCR5 Final Proposals from 1 April 2010.

In summary, CN propose to restructure their methodology as follows:

- 'Part A' will refer to HV and LV charges for demand and generation covered by the CDCM, and essentially signpost the CDCM and governance arrangements;
- 'Part B' refers to EHV charges for demand and generation, for which the methodology is essentially unchanged. Demand charges will continue to be set on the current basis, using CN's existing distribution reinforcement model. Charges for generators connected post April 2005 will continue to be set using the methodology they currently use. Generators connected prior to April 2005 will continue to not be charged use of system charges.

To take account of DPCR5 Final Proposals, which will require DNOs to calculate a single pot of allowed revenue, CN also propose to add details of how they calculate specific allowed revenues for scaling EHV demand and generation charges.

Reasons for the Authority's decision

The Authority has decided to **not veto** CN's proposal. In coming to our decision the Authority has considered the proposed modification against the relevant objectives and the Authority's principal objective and wider statutory duties¹⁰.

In general, we consider that CN's proposals are necessary to ensure that their EHV methodology continues to be clear and operable following the implementation of the CDCM and DPCR5 Final Proposals. Our decision is based on CN's proposal better achieving relevant objective (d). Detailed reasons for the Authority's decisions are set out below.

⁸ A press release explaining that DNOs had accepted our Final Proposals in principle was published on 8 January 2010. Please see http://www.ofgem.gov.uk/Media/PressRel/Documents1/Dp5%20acceptance_1_2010.pdf

⁹ DNOs' existing methodologies for calculating UoS charges for use of the higher voltages of their networks – i.e. the EHV are likely to remain in place until the end of 31 March 2011. From 1 April 2011 common EDCMs will replace existing EHV charging methodologies. For further information see our July 2009 decision letter at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=487&refer=Networks/ElecDist/Policy/DistChrgs>

¹⁰ The Authority's statutory duties are detailed mainly in the Electricity Act 1989, Gas Act 1986, Utilities Act 2000, Competition Act 1998, Enterprise Act 2002 and the Energy Act 2004 as well as arising from directly effective E.C. legislation.

Relevant objective (d) – that so far as is consistent with sub paragraphs (a), (b) and (c), the methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's distribution business

Under SLC 13A and 50, on 1 April 2010 CN is obliged, along with other electricity distribution licensees, to implement and comply with the CDCM and to have revoked their existing HV/LV charging methodologies from their SLC 13 UoS Charging Methodology¹¹. On the same day, DPCR5 Final Proposals will be implemented. In light of these changes in its distribution business, CN's proposal will amend their SLC 13 UoS Charging Methodology to ensure that it remains a complete and documented explanation, presented in a coherent and consistent manner¹², whilst making no substantive changes to the calculation of EHV charges. In particular it will make clear that CN's Charging Methodology pursuant to SLC 13 specifically explains the calculation of EHV charges.

Generally speaking, CN propose to make incidental changes to their SLC 13 UoS methodology to ensure that following the revocation of their HV/LV methodologies it remains a complete and documented explanation presented in a coherent and consistent manner. These changes include updating references to the licence and including new references to the CDCM. We consider that these changes are intended to clarify that the SLC 13 UoS methodology only applies to EHV charges and are appropriate to facilitate the introduction of the CDCM.

The most substantive change that CE proposes is to make it clear how allowed revenue is calculated and used in conjunction with the CDCM. That is, the total amount of allowed revenue to be recovered from HV/LV customers through the CDCM is calculated by subtracting EHV demand and EHV generation revenues, which are calculated in accordance with their proposed methodology statement, from the total allowed revenue that is determined in accordance with their licence. We consider that improving the clarity of the revenue reconciliation process is necessary following the implementation of DPCR5 Final Proposals, which will make changes to each DNO's licence in relation to calculating allowed revenue. CN's proposal will ensure that total allowed revenue is clearly apportioned between the EHV and HV/LV methodologies.

Following the publication of DPCR5 Final Proposals, CN also make clear in their methodology that an exemption that currently applies to them from not charging pre-2005 DG will expire on 1 April 2010. Consequently, in collaboration with other distribution businesses and industry stakeholders, CN plan to develop and implement appropriate arrangements for charging pre-2005 DG. CN propose to continue not to charge pre-2005 DG until such arrangements are implemented. We consider that in light of the policy implemented by DPCR5, the clarity CN have added to their methodology is welcome and should effectively manage stakeholders expectations in relation to pre-2005 DG charging.

In light of the impending implementation of the CDCM and DPCR5 Final Proposals, we consider that all changes proposed by CN are necessary and will ensure users of their methodology continue to be able to interpret it clearly. Therefore, we consider that their proposals will take account of changes in their distribution business and better achieve Relevant Objective (d) and its implementation is consistent with our principal objective and statutory duties.

¹¹ Which, until 1 April 2010, covers the calculation of charges for HV/LV and EHV customers.

¹² See SLC 13.14.

Further comments

Finally, we note that CN propose to redraft their LLF¹³ Methodology in light of the introduction of Balancing and Settlement Code modification P216 'Audit of LLF Production'¹⁴. Whilst the LLF Methodology is not a requirement of the SLC 13, we expect that CN redraft their methodology and republish it as an appendix or stand alone statement as soon as possible. Should CN publish their LLF Methodology in a stand alone document then we expect them to refer to it from their SLC 13 statement to ensure that users are aware that it is published separately and where it can be found.

If you have any questions relating to the issues discussed in this letter please contact Nicholas Rubin, either at nicholas.rubin@ofgem.gov.uk or on 020 7901 7176.

Rachel Fletcher

Partner, Distribution

Signed on behalf of the Authority and authorised for that purpose

¹³ Line loss factor.

¹⁴ Which was approved by the Authority on 24 April 2008 and implemented on 20 April 2009 – see <http://www.elexon.co.uk/changeimplementation/modificationprocess/modificationdocumentation/modProposalVjew.aspx?propID=236>