

Charges for pre-2005 Distributed Generators' use of DNOs' distribution systems

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Target audience: Distribution network operators, suppliers, generators and other interested parties

Overview:

This document consults on the issues raised by Distribution Network Operators' development of proposals for charging pre-2005 distributed generators (DG) for use of their electricity distribution systems.

As part of the new electricity distribution price control arrangements (DPCR5) that came into effect in April 2010, Ofgem lifted a five year exemption on pre-2005 DG from paying use of system charges. The DNOs are also required to develop common charging arrangements for EHV customers for implementation from 1 April 2011 and these arrangements will need to include the charging approach for all DG customers.

We seek respondents' views on the charging methodology for pre-2005 DG and the high level principles governing the calculation and payment of compensation to pre-2005 DG where it may be appropriate.

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Context

Generator use of system charging was introduced in 2005 along with a change in the connection charging boundary. At that time, Ofgem granted an exemption from charges to distributed generation connected under pre-April 2005 terms. This exemption was granted for the period from 1 April 2005 to 31 March 2010. Ofgem decided not to extend this exemption and it fell away on 1 April 2010 when charges based on a new common methodology began to apply to customers connected to the lower voltages of distribution networks.

Distribution network operators (DNOs) have an obligation to have in place a charging methodology that meets certain relevant objectives, including the requirement not to distort competition and to reflect developments in their businesses. Charges to customers on the higher voltage levels will be common, subject to Authority approval of DNOs' proposals, from 1 April 2011. Common charges were introduced for customers connected to the lower voltages on 1 April 2010.

Industry discussion this year has focussed on an assessment of the contracts that DNOs hold with their DG customers. Part of this debate has centred on whether some generators that connected pre-2005 should receive compensation when they begin to pay charges, and if so, the basis for calculating the compensation due. We acknowledged at DPCR5 that compensation may be warranted in some circumstances and included a logging up mechanism to allow the DNOs to recover these costs where economic and efficient. This consultation seeks views on the high level principles that should be applied by Ofgem when it assesses the efficiency of any compensation payments (bearing in mind that the principles Ofgem arrives at may ultimately guide the behaviour of DNOs in this respect). It also seeks views on whether any compensation should be bundled or unbundled from use of system charges for generators at the higher voltages when they start to be charged from April 2011.

Associated Documents

- DNOs' modification reports in respect of charges for pre-2005 distributed generators' use of DNOs' distribution systems, June and July 2010
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=703&refer=NETWORKS/ELECDIST/POLICY/DISTCHRGMODS>
- Electricity Distribution Price Control Review Final Proposals – Incentives and Obligations, December 2009 (Reference number: 145/09)
http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/FP_2_Incentives%20and%20Obligations%20FINAL.pdf
- Electricity Distribution Price Control Review Initial Proposals – Incentives and Obligations, August 2009 (Reference number: 93/09)
http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Initial%20Proposals_2_Incentives%20and%20Obligations.pdf

- Structure of electricity distribution charges - Initial decision document, November 2003
http://www.ofgem.gov.uk/Licensing/ElecCodes/DistCode/Mods/Archive/5150-Structure_elec_dist_charges_14nov03.pdf

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Summary

This document consults on the approach that distribution network operators (DNOs) should adopt for introducing use of system (UoS) charges for pre-2005 distributed generators (DG) and on the high level principles for determining any compensation that may be due.

The five year exemption that pre-2005 DG customers had from UoS charging expired on 1 April 2010 and, after consulting on this matter as part of our work on DPCR5, we decided not to extend this exemption. We lifted the exemption to encourage the efficient use of the distribution networks and to create a level playing field for competition in generation. We envisaged that DNOs would start to charge pre- and post-2005 DG customers on the same basis and that any deviations would need to be well justified to Ofgem to ensure that there was no undue discrimination against (or in favour of) any type of DG customers.

From 1 April 2010, and with the introduction of the common charging arrangements for high and low voltage customers (CDCM), pre-2005 DG connected at lower voltages have been subject to the same UoS charging methodology as all other DG at this voltage level. However, DNOs are yet to change the charging arrangements for pre-2005 DG connected at extra high voltage (EHV).

Having pressed DNOs to address this issue, Ofgem has received proposals aimed at introducing charging arrangements for pre-2005 DG at EHV from six of the seven groups. We have reviewed these proposals and have decided not to progress them at this time as they represent a range of different approaches and highlight a number of unresolved issues relating to the treatment of compensation to generators. The DNOs have withdrawn their modification proposals. We will continue to work with industry to agree the arrangements for DG customers that should come into effect on 1 April next year with the introduction of common charging arrangements for EHV customers (the EDCM).

At DPCR5 we recognised that there may be cases where pre-2005 DG customers are entitled to compensation following the removal of the charging exemption and we put in place a logging up mechanism to allow the DNOs to recover from the generality of customers any efficiently incurred compensation payments.

This compensation could be returned to customers by bundling it with use of system charges, or dealing with it as a separate matter - an unbundled approach. We are minded to adopt an unbundled approach which would mean that, as for DG connected at lower voltage, all pre-2005 DG at EHV would become eligible to pay use of system charges with the introduction of the EDCM on 1 April 2011. We note that in some cases DNOs and generators may need to renegotiate their contracts before these charges can apply. We prefer the unbundled approach to the alternative (which would look to reflect compensation arrangements in the charges) primarily due to simplicity and because it preserves the desired price signals to DG. This consultation seeks views on this approach.

It is for DNOs to take their own legal advice on the implications of the contractual terms they have entered into and to agree with the DG customers concerned what

compensation payments (if any) are appropriate. Where DNOs have already done this, it has been of significant help in progressing the debate about compensation arrangements and we would encourage DNOs to continue work in this area. However, we recognise that DNOs will seek to ensure that the payments they make are compatible with the test Ofgem will apply to logged up costs at the end of this price control period. We are also aware that Ofgem is cited in many DG connection contracts as the body for determining disputes. For both of these reasons we consider it is appropriate that we begin work to consider the high level principles for determining appropriate compensation.

This consultation kicks off our consultation process to determine these principles. We expect we will have to consult further on this matter and will discuss with DNOs and DG customers whether the process would be helped by a limited number of contract disputes being brought to us for determination over the coming months. Our aim at this stage is to create a set of principles that can be applied to the vast majority of generator contracts without recourse to Ofgem for determination.

We think that the decision on whether compensation is due and how it should be calculated should depend on the contractual rights of each DG customer and what is considered to be fair. Issues of fairness are aimed at avoiding DG customers having to pay twice for some services/assets such as operation and maintenance costs that were included in pre-2005 DG connection charges but also form part of use of system charges going forward. We also think it is important to consider precedent on this matter and the practicality of any arrangements, bearing in mind that there is not always clear information on the duration of contracts or what upfront payments were meant to cover. With this as a starting point, we have set out three stylised approaches to compensation and seek comments on these approaches and further evidence from respondents on contractual terms and payments made.

The EHV Distribution Charging Methodologies (EDCM) are due to be submitted by the DNOs to Ofgem on 1 September for approval and these methodologies will take effect from 1 April 2011. We are keen that our decision on the nature of any compensation (bundled or unbundled) is taken into account in the submissions and we have adopted a shortened consultation period on this issue to facilitate this process. The closing date for consultation responses on this matter is 18 August 2010. The closing date for responses to our questions relating to compensation principles is 1 September 2010.

1. Background

Chapter Summary

This chapter sets out the background to the introduction of use of system charges and its applicability to generators that connected to DNOs' distribution systems on pre-April 2005 connection terms. It discusses the change in policy that was made at DPCR5 and why this raises the issue of compensation for pre-2005 DG customers.

Purpose of this consultation

1.1. This document seeks views on the approach DNOs should adopt for introducing use of system (UoS) charges for pre-2005 distributed generators¹ (DG) and on the high level principles for determining any compensation that may be due.

1.2. We aim to obtain sufficient clarity on the charging and related compensation principles in time to allow the common charging arrangements for EHV customers (the EDCM) to come into effect by April 2011.

1.3. DNOs will submit their EDCM proposals to us by 1 September 2010. We may undertake further consultation on the issues raised in relation to charging pre-2005 DG as part of our planned overall consultation on the EHV Distribution Charging Methodology (EDCM).

Rationale for the staggered approach to consultation

1.4. We have different timelines for the consultation on the two key issues in this paper as follows:

- There is a **4 week consultation period** on the issue of whether any compensation for EHV generators should be bundled or unbundled from use of system charges. This is a relatively simple issue that necessitates a shortened consultation period to allow Ofgem to make a decision ahead of the DNOs submissions of their EDCMs and allow them to build this decision into the methodologies. This issue is considered in Chapter 3.

¹ We use the phrase pre-2005 DG as shorthand to refer to DG customers that connected on pre-April 2005 terms even though the connections may not have been completed until after this date.

- There is a **6 week consultation period** on the principles that should be adopted when assessing the efficiency of any compensation paid by DNOs to pre-2005 DG customers. Ofgem's ultimate decision on this issue does not affect the charging methodologies themselves so there is no need for a shortened consultation period. We also recognise that this is a complex matter that may need several rounds of consultation - and perhaps some "test case" determinations before we can reach a landing. We consider principles for compensation in more detail in Chapter 4. Chapter 2 sets out our current understanding of the contractual arrangements that are in place between DNOs and pre-2005 DG and seeks further information from respondents.

Structure of Charges project

The connection charging boundary

1.5. In April 2005 Ofgem amended the policy in relation to the connection charging boundary which determined the charges for connecting to electricity distribution network operators' networks. For demand and generation customers the boundary was amended from a 'deep' connection boundary to a 'shallowish' boundary. The connection charging boundary was aligned between demand and generation customers and use of system charges were introduced for generators from that time.

1.6. Previously the deep connection boundary meant that customers connecting to a DNO's network were expected to pay a connection charge equal to the cost of all assets required to connect them to the existing system and any other reinforcement to the shared network that was necessary to connect them. Payments were generally one-off and made upfront and there was generally no recourse made to customers when original assets required replacement. In practice the deep boundary policy served to encourage generators to connect to the network where wider reinforcement was not required and where they did not have to bear the associated costs.

1.7. A shallowish boundary means the generator pays the cost of all assets necessary to connect them on to the existing distribution system plus a proportion of the costs necessary to reinforce the shared network. The remaining costs are recovered from all users of the network. The boundary from 2005 was aligned for demand and generation customers and this also entailed a change for demand customers at that time. From 2005, the treatment of operation and maintenance (O&M) costs also changed. Previously O&M costs were levied as part of the connection charge whereas from 2005 all O&M costs are paid for as part of the ongoing use of system charge.

1.8. Since 2005 DNOs have been obliged to publish details of their use of system charging methodologies in methodology statements.

1.9. Data collected as part of DPCR5 suggests that there was around 12GW of connected DG capacity during DPCR4 of which 11GW is pre-2005 DG. Of this total capacity around 8GW was connected at EHV and 7.5GW of this related to pre-2005 DG. The pre-2005 DG capacity represents approximately 270 DG customers.

Longer term UoS charging arrangements

1.10. Since 2000 Ofgem has been encouraging DNOs to make improvements to charging models, in particular at the highest voltage levels. Our consultations have pointed out the need for methodologies to take into account developments in the distribution system (such as the emergence of independent networks and the increase in DG) and have stressed the importance of cost reflective charges for the efficient development and use of the network. DNOs did not deliver revised, more cost reflective charges in time to align with the new connection boundary in 2005 and initially simplistic, interim arrangements were introduced in respect of charges to new DG connecting from April 2005 onwards. It was envisaged that the interim arrangements would be replaced by longer term arrangements developed and implemented by DNOs in the period 2005 to 2010.

1.11. Ofgem also exempted distributed generators (DG) connected on terms agreed pre-April 2005 from being charged for use of system for a five year period and that the position would be reviewed as the longer term arrangements were developed². The exemption recognised that pre-2005 DG had agreed connection terms under the 'deep' connection charging policy and that DNOs still needed to develop suitable longer term, cost reflective UoS charging arrangements for DG (and other customers) as soon as possible and in advance of 2010. This exemption was seen as a form of compensation as pre-2005 DG customers had paid the full costs of any reinforcement work and the deep connection charge also often included an element representing operation and maintenance costs which were not included in the shallowish connection charges from 2005 onwards³.

1.12. From 1 April 2010 the DNOs implemented common charges for customers connected at the lower voltages of their networks, including to all distributed generators. The charging methodology in force from April 2010 for DG customers connected at HV/LV and based around a fixed charge plus credits for generation - under this approach most DG customers at these voltage levels are expected to have negative net charges. Common arrangements are being developed at the highest voltage levels for implementation in April 2011.

² Ofgem made it clear in paragraph 5.11 of DPCR4 Final Proposals (<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR4/Documents1/8944-26504.pdf>) and in paragraph 3.34 of 'Structure of electricity distribution charges - licence modifications - update document' (<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/6744-April04%20Update%20Document%20SoC%20final.pdf>) that allowed revenue for UoS should only be recovered from generators connecting to a DNO's network after April 2005.

³ See paragraph 5.25 of our 'Structure of electricity distribution charges - Initial decision document' in 2003: http://www.ofgem.gov.uk/Licensing/ElecCodes/DistCode/Mods/Archive/5150-Structure_elec_dist_charges_14nov03.pdf

DPCR5 position on pre-2005 DG charging

1.13. The exemption that pre-2005 DG customers had from UoS charging expired on 1 April 2010 and, after consulting on this matter as part of our work on DPCR5, we decided not to extend this exemption. We explained in our price control Final Proposals that the purpose of not extending this exemption was to ensure that the charging framework developed by DNOs does not have the effect of unduly discriminating against (or in favour of) pre-2005 connected DG and that use of system charges to all DG reflect the costs that they impose (or defer) by connecting to and using the network. The benefits from this approach were to encourage the efficient use of the distribution networks and to facilitate competition in generation. Our decision in relation to the exemption from charging pre-2005 DG is set out in Chapter 4 of our DPCR5 Final Proposals: Incentives and Obligations document.

1.14. We envisaged that DNOs would start to charge pre- and post-2005 DG customers on the same basis and that any deviations would need to be well justified to Ofgem to ensure that there was no undue discrimination against (or in favour of) any type of DG customers. These arrangements came into effect for DG connected to the HV/LV system on 1 April 2010. From this date pre-2005 DG connected at lower voltages have been subject to the same UoS charging methodology as all other DG at this voltage level.

1.15. We recognised that there may be cases where it may not be unduly discriminatory for there to be a further period over which the DNO does not levy use of system charges. In such cases we would require the DNO to justify why charges should not apply and to demonstrate with credible evidence that they are offering non-discriminatory terms. However, we also set out our position that it would be administratively simpler if all DG paid use of system charges on the same basis using a common methodology and this is the approach that we expect DNOs to follow except in cases where they can demonstrate that this is not appropriate. This preferred approach would remove any administrative burden (and the associated costs) on DNOs, DG and Ofgem to monitor and police the arrangements to ensure that DNOs are meeting their legal obligations not to discriminate unduly. To facilitate this as part of DPCR5 we explained that we would like to see DNOs explore whether they can refund the DG for the relevant proportion of their connection charges in return for paying use of system charges which provide a better price signal to DG about the impact that they are having on network costs.

1.16. Our Final Proposals recognised that the introduction of use of system charges for pre-2005 DG may give rise to cases where there is a legitimate need for compensation to be paid to DG customers (e.g. where the DG customer had paid for reinforcement of the network and the reasonable life of this investment has not expired). We stated that any compensation paid to DG customers could be logged up by DNOs until DPCR6 when Ofgem would undertake an efficiency assessment to allow the DNOs to only recover payments that were economic and efficient.

1.17. It is for DNOs to take their own legal advice on the implications of the contract terms they have entered into and to decide (through discussions with the DG customers concerned) what compensation payments (if any) are appropriate.

However, we recognise that DNOs will seek to ensure that the payments they make are compatible with the "economic and efficient" test Ofgem will apply to logged up costs at the end of this price control period. We are also aware that Ofgem is cited in many of the DG connection contracts as the body for determining disputes. For both of these reasons we consider it is appropriate that we being work to consider the high level principles for determining economic and efficient compensation.

1.18. Chapter 4 of this consultation seeks views on the principles that should be applied by Ofgem in determining this level of compensation to be recovered through the price control.

Undue discrimination and licence requirements on DNOs

1.19. Standard licence condition (SLC) 19 sets out two provisions of importance in relation to the charging of pre-2005 DG. SLC 19.1 requires that the licensee must not discriminate between any person or class or classes of person in, amongst other things, providing Use of System. SLC 19.2 requires that the licensee must not make charges for providing Use of System to any person or class or classes of person that differ from charges for such provision to any other person or class or classes of person except insofar as the costs of provision are different.

1.20. The normal meaning of "discrimination" is to differentiate or make a distinction. Discrimination may be lawful or unlawful. There could be no objection to a licensee discriminating lawfully. The references to discrimination in the licence conditions are intended to prohibit only unlawful discrimination, often referred to as "undue discrimination".

1.21. Undue (or unlawful) discrimination may occur where similar groups are treated differently without objective justification. In the current situation, this means that the DNOs should treat similar DGs in a similar way. Treating similar DGs in different ways may place some parties at a competitive disadvantage and would be unlawful unless there is objective justification for the different treatment.

1.22. However, it may be appropriate to recognise certain groups of DG as having different characteristics. Different treatment for those groups might be objectively justified if the different treatment is appropriate, bearing in mind their different characteristics.

1.23. Following the cessation of the exemption from charging pre 2005 DG for UoS, pre- and post-2005 DG customers should be treated in the same way in relation to the provision (in particular the charging) for UoS unless there is objective justification for different treatment. Unjustified differences in treatment of pre- and post-2005 DG may constitute undue discrimination and therefore may put the DNOs at risk of being in breach of requirements in SLC 19. Possible justifications for different charging of DGs may be the costs involved in providing UoS.

1.24. Compensation principles also need to be applied by DNOs in a non-discriminatory manner. Different DGs may have had different contractual rights which might justify different compensatory treatment in some cases.

1.25. As part of DPCR5 and in correspondence following Final Proposals, we identified that the expiry of this exemption would require DNOs to review their contractual terms with their DG customers and ensure that they were not discriminating between them. We also stated that where DNOs do not have written contracts with a DG plant that we expected them to introduce written terms as soon as practicable so that all DG schemes have clear, enforceable contracts in place.

1.26. We recognised that there may be cases where it may not be unduly discriminatory for there to be a further period over which the DNO does not levy use of system charges. In such cases we would require the DNO to justify why charges should not apply and to demonstrate with credible evidence that they are offering non-discriminatory terms.

Developments since the publication of DPCR5 Final Proposals

1.27. Since concluding the DPCR5 review, we have written to the DNOs on several occasions to encourage them to move quickly to put in place charging arrangements for pre-2005 DG.

1.28. All DNOs⁴ except EDF Energy Networks brought forward modifications in respect of existing EHV-level DG charges in late June / early July 2010. In preparing their modification proposals, the DNOs and DG customers spent significant time discussing charging and compensation arrangements. They have also taken a detailed look at the connection agreements they hold with DG customers to get a better understanding of the terms of these agreements. These are welcome developments. Nonetheless, the six modification proposals represent a range of different approaches to pre-2005 DG charging and compensation arrangements. We are concerned at the differences between DNOs at a time where methodologies will be common from April 2011 and that, if approved, the arrangements in respect of October 2010 to April 2011 may not mirror those that are put in place for April 2011.

1.29. We also think that the timescale for considering these proposals means that an October 2010 change in charges is not now possible. In particular, there is insufficient time to carry out the length and detail of consultation that is required before making changes that would, in some circumstances, lead to substantial UoS charges for this category of users. For these reasons the DNOs have agreed to withdraw these interim modifications and we are working towards a common

⁴ Central Networks, CE Electric, Electricity Northwest, ScottishPower, Scottish and Southern Energy and Western Power Distribution.

charging methodology for all DG customers that will take effect from 1 April 2011 as part of the EDCM.

Structure of this consultation document

1.30. The remainder of this document is structured as follows:

- Chapter 2 sets out Ofgem's current understanding of the contracts in place between DNOs and DG and seeks further details from respondents.
- Chapter 3 discusses the issue of whether use of system charges and compensation should be bundled or unbundled. It sets out Ofgem's minded to decision for an unbundled approach and seeks views on this proposal.
- Chapter 4 seeks views on the principles that Ofgem should follow when assessing the efficiency of the compensation paid by DNOs to pre-2005 DG customers. These principles will be applied by Ofgem at DPCR6 when it sets the compensation allowance that can be recovered through the price control.
- Chapter 5 sets out our next steps in terms of developing policy in this area.

2. Existing pre-2005 DG contracts

Chapter Summary

This Chapter sets out Ofgem's current understanding of the contracts in place between DNOs and DG customers and seeks further details from respondents.

Nb. Responses to this chapter should be submitted to Ofgem by 1 September 2010.

Question box

Question 1: We invite respondents to provide further information they have on contractual arrangements and the extent to which the descriptions in this chapter fit their own circumstances.

Question 2: Do respondents agree with our understanding of the arrangements affecting CVA and SVA customers?

Question 3: Do you consider our summary of contractual issues is accurate and complete?

Contractual position for pre-2005 connected generators

Information collected as part of DPCR5

2.1. As part of our DPCR5 Initial Proposals we asked DNOs to carry out a detailed review of contracts relating to DG such that they would be able to address the removal of the charging exemption on these users.

2.2. The DNOs' response to our information request raised a number of issues with the contractual arrangements they have with DG, for example:

- Many connection agreements may not define clearly the extent of the DG's right to use the distribution system (UoS rights). In a large number of cases contracts are silent on this matter.
- Some customers may have accepted offers on the basis of non-firm capacity rather than paying the full costs of deep reinforcement.
- In some cases it is not clear to what extent DG customers paid for anything other than connection to the DNO's network and the maintenance of that connection. For example, it is not transparent whether they paid for the future replacement of any of the network assets.

- Many connections to DNOs networks were made some time ago and the DNOs' records of details of the connection, e.g. details of contracts and payments are often incomplete or missing.
- The position of existing generators with regard to contributions towards replacement of joint-use assets is often unclear.
- The majority of contracts contain a clause that permits the terms of contracts to be varied by mutual consent or following determination by Ofgem.
- Whilst many contracts tend to follow a similar form, there do appear to be a very small number of "non-standard" contracts/arrangements that may require special consideration.

CVA and SVA customers

2.3. DG customers connected to the DNOs' networks can be categorised as either being registered in Supplier Volume Allocation (SVA) or Central Volume Allocation (CVA). Whilst the detailed terms of SVA and CVA registration are explained in the Balancing and Settlement Code, the essential difference in this context is that an SVA DG customer's relationship with a DNO is via a supplier and a CVA DG customer's relationship is directly with the DNO. Consequently the DNO charges a supplier for SVA customers' UoS⁵ and charges CVA customers directly for their UoS. In both circumstances the DNOs' relationship with either a supplier or customer should be governed by contractual arrangements - the Distribution Connection and Use of System Agreement (DCUSA) in relation to Suppliers and bilateral agreements in relation to CVA customers. Our understanding is that vast majority of DG are SVA customers.

2.4. An issue raised by DNOs is that their existing bilateral agreements with CVA pre-2005 DG may need renegotiating to make sure that terms in relation to UoS and payment for UoS are clear. We note that many contracts are silent regarding use of system charges for generators, and that some contracts will need to be amended to allow DNOs to charge DG for use of their networks. Where contracts need to be amended, and parties cannot agree on the appropriate revised contract terms, parties may be able to refer the disputes to the Authority to determine.

2.5. However, because the DCUSA governs their relationship with suppliers and therefore already allows them to charge for UoS in relation to SVA pre-2005 DG, some DNOs suggest no renegotiation of contracts or payment of compensation is necessary in these cases.

⁵ It is then the supplier's decision how to pass on the costs of UoS.

2.6. We welcome views from respondents on whether they agree with our understanding of the arrangements for SVA and CVA customers.

Other information

2.7. In addition to our work as part of DPCR5, the DNOs hosted workshops to discuss pre-2005 DG charging. At these workshops it was considered by DG representatives that whilst contracts may not explicitly refer to rights to UoS, that these were implicit. That is, prior to the development and implementation of a change in the connection boundary, some DG customers consider that there was no difference between the use of a DNO's distribution system and the recognised right to connection. They argue that a customer paid a deep connection charge to not only cover the actual connection to the DNO's network but also, implicitly, to cover the customer's use of the system too. It was not until the connection boundary was reviewed and ultimately changed that a distinction between connection and UoS was properly defined. As such some DG customers have argued that their pre-2005 connection agreements also implicitly cover UoS.

2.8. Furthermore, there is a mixture of views on how long DG customers have rights in accordance with their contracts. Some consider that rights are for a finite period and our understanding is that many contracts are explicitly for a certain time period, typically for a c.20 year period. Some DG customers consider that the duration of their rights to connection and use of system are "evergreen", (to mean that they will run in perpetuity), although it is unclear that such rights are explicitly set out in their contracts with DG.

2.9. There are currently differing interpretations of the rights supposedly conveyed within the contracts between DNOs and DG customers and this has held up progress on this issue.

2.10. We are keen to better understand the detailed contractual rights that are provided in contracts between DNOs and pre-2005 DG. In this respect we invite respondents to share with us details of their contracts or connection arrangements, including any legal interpretation they may have procured.

2.11. We discuss the implications of these contractual arrangements on the case for compensation further in Chapter 4.

3. Compensation and use of system charges: bundled or unbundled

Chapter Summary

This chapter discusses the issues associated with the bundling or unbundling of compensation and use of system charges. It sets out our minded to decision to adopt an unbundled approach to be incorporated into the EDCM.

Nb. Responses to this chapter should be submitted to Ofgem by 18 August 2010.

Question box

Question 1: Have we identified the relevant considerations that influence the decision whether to adopt a bundled or unbundled approach?

Question 2: Do you agree with our minded to position to adopt an unbundled approach for the EDCM?

3.1. If compensation is appropriate in some cases then it must be decided how these sums should be returned to relevant DG customers. This chapter discusses whether this compensation should be bundled or unbundled with UoS charges. This issue is only relevant to EHV pre-2005 DG customers and how the EDCM will be specified. The interim charging modification recently submitted by the DNOs (and subsequently withdrawn) used a combination of the bundled and unbundled approaches. The CDCM which covers lower voltage pre-2005 DG customers has not included any provisions for compensation within the charging methodology i.e. any compensation that may be paid out would be unbundled from UoS charges.

Bundled versus unbundled

3.2. Following the lapse of the charging exemption for pre-2005 DG customers there will need to be changes to the charging methodologies of the DNOs to ensure that the charging arrangements treat all DG customers fairly. Any compensation payable must be calculated on a basis distinct (or capable of being distinguished) from the charging methodology. In cases where compensation is warranted we consider that there are two broad approaches for making changes to the DNOs' charging arrangements:

- The **unbundled** option treats all DG customers the same in the charging methodology and any compensation due is paid independently of the charging arrangements. This would help to ensure that the DNOs' charging statements are relatively simple and apply the same methodology to all DG regardless of when it connected or under what terms.

- The **bundled** option incorporates the payment of any compensation into the charging methodology. This could be achieved either through a discount (time-limited) to UoS charges or a continued exemption (time-limited) from UoS charges. In this case, the charging statements would be more complex with different charges (including zero charges in some cases) for different classes of customer depending on when they connected and other aspects of their connection contract

3.3. These two options are reflected in the interim proposals submitted by DNOs. For example, WPD's proposal was unbundled whereas SSE's proposal was bundled.

Ofgem's minded to decision

3.4. Ofgem sees a strong merit in adopting an unbundled approach to be reflected in the EDCM for the following reasons:

- UoS price signals are unaffected by any compensation and this meets our aim of facilitating the efficient development and use of the network.
- It allows DNOs to bring forward EDCM proposals for 1 September 2010, ahead of the detailed approach to compensation having been finalised.
- It would lead to a simple use of system methodology for DG.
- It will allow DNOs to make case by case decisions on compensation without having to reflect this in the charging methodology.
- Recording and reporting details of compensation paid is likely to be administratively simpler and less burdensome on the DNOs and Ofgem.
- It is compatible with the approach taken to charging DG in the CDCM.

3.5. By contrast the bundled approach presents the following issues:

- Incorporating compensation into a UoS methodology may not technically be correct, i.e. the methodology is intended to be for the determination of charges for UoS, not compensation.
- It could be challenging to ensure that compensation is paid consistently when a methodology may change over time.
- It will be difficult to track how much compensation has been paid to a particular customer and DNOs may still be exposed to the risk of accusations of undue discrimination.
- The Authority has to approve the charging methodology. This may present complications when Ofgem is also required to determine disputes over compensation.
- It may lead to very complex and detailed charging arrangements for DG which are difficult to understand.
- Pre-2005 DG may receive weaker price signals than those intended by the charging principles which are designed to encourage efficient use of the system and avoid any undue discrimination.

3.6. We do not see any strong argument in favour of the bundled approach as we think that it only complicates matters without offering any strong offsetting benefit.

We therefore are minded to adopt the unbundled approach for the EDCM. We welcome views from respondents as to whether they agree with this position.

3.7. We recognise that some DG will only begin to be charged for UoS once contracts are changed and that this is unlikely to happen if compensation has not been agreed. This issue is most likely to be relevant for CVA customers and therefore these customers have some protection until compensation has been resolved. To facilitate this process, we are seeking as part of this consultation to progress with the development of the principles that we will use to assess the efficiency of any compensation. We also note that this issue with some CVA customers is compatible with the unbundled approach as it will allow simpler implementation of the EDCM by 1 April 2010 – the relevant DG customers will only start to be charged once the compensation and contractual issues have been resolved.

4. Principles for assessing the efficiency of any compensation paid

Chapter Summary

This chapter seeks views on the high level principles to be applied by Ofgem at DPCR6 when assessing the efficiency of any compensation that the DNOs have logged up over the DPCR5 period.

Nb. Responses to this chapter should be submitted to Ofgem by 1 September 2010.

Question box

Question 1: We welcome views on the criteria that should be applied to determine when it is appropriate to pay compensation.

Question 2: When it is appropriate, what method(s) should be used to calculate the level of compensation?

Question 3: Do respondents consider compensation to be appropriate in cases where contracts allow for a variation when charging arrangements change? If so, why? Our understanding is that this is the case for all SVA generators and some CVA connected generators.

Question 4: Where contracts are not explicit that UoS charges are included within the terms of the connection, do pre-2005 DG customers have any rights to compensation based on the value of expected UoS charges? What would be the justification for this?

Question 5: We welcome views from respondents as to whether the same compensation principles should apply to HV/LV customers as to EHV customers and whether the same contractual and fairness issues apply.

Question 6: Are there any other proposals or relevant issues that we have not identified in this consultation that you think should inform our policy development going forward?

Question 7: We would welcome evidence from respondents that would allow Ofgem to assess the potential magnitude of the compensation that might be due under the different approaches that might be adopted to assessing compensation.

Question 8: We welcome views and evidence on the approach that should be adopted in the case of special contracts that grant rights in excess of standard rights and whether any compensation due should all be funded by customers through the price control.

Question 9: We invite any other views and comments about users' contracts that may help us to develop our proposals.

4.1. This chapter sets out some initial high-level principles that might be used to determine when compensation is warranted and how the level of compensation should be calculated. We welcome views from respondents to help us develop our policy in this area.

4.2. We consider that the calculation of compensation is an exercise for DNOs and DG customers. However should compensation be appropriate under the circumstances, we have already proposed that the costs of such compensation may be logged up and an allowance made for it as part of DPCR6. If the costs of compensation are to be reviewed as part of DPCR6, we recognise that Ofgem has a part to play in setting out principles so that DNOs better understand the assessment that Ofgem will undertake to determine whether compensation payments were economic and efficient. We would expect that allowances for compensation to be based on evidence supporting the compensatory payment.

4.3. Further to the interim proposals raised by some DNOs and discussions held between the DNOs, DGs and Ofgem, there appear to be several reasons why compensation may be necessary and there exist several possible methods for calculating the relevant compensation. The next section discusses the rationale for compensation in some cases and then we discuss the high-level principles that might apply to deciding when it is appropriate and the level that the compensation should be. We seek views and evidence from industry to help develop the principles that Ofgem will apply at DPCR6.

Rationale for compensation in some cases

4.4. Any compensation is intended to make up for loss or damage suffered. In the case of pre-2005 DG customers, any loss or damage they have suffered would be assessed by reference to changes to their existing contractual rights. As we have set out in Chapter 2 the contractual arrangements between DNOs and pre-2005 DG customers are not always clear which gives rise to a number of possible rationales for considering the need for compensation after the introduction of UoS charges. In considering appropriate compensation arrangements we think it is appropriate to look at both the content of the connection contracts and issues of fairness as follows:

- **Contractual rights:** Some pre-2005 DG customers may have contracts in place that give them explicit or implicit rights to use the network under particular terms. Altering these contracts to introduce UoS charges may require compensation to be paid.
- **Fairness:** Some parties have argued that compensation might be payable to pre-2005 DG to recognise the change in regulatory policy. Regulatory policy should have been reflected in pre-existing contracts but there may be cases where this has not happened for some reason. For example, it may be appropriate to refund the unexpired amount of the original connection charge or the unexpired capitalised O&M costs included within this charge so that pre-2005 DG customers do not pay twice for the same assets/service even if they are not contractually entitled to any refund.

Approach to calculating compensation

4.5. The appropriate approach to determine the level of compensation involves a number of considerations that we have identified:

- the rights that are embedded in the contract;
- the precedents that there have been e.g. the experience of demand customers following the change in the connection charging boundary in 2005;
- fairness and ensuring as far as possible that competition between generators is not distorted; and
- the practicality of implementing any approach.

4.6. We have reviewed the interim modification proposals forwarded to us by the DNOs and based on this and on further discussions with the industry, we have identified a range of different approaches to calculating compensation. We summarise these below and invite comments on these different approaches.

No compensation

4.7. Under this option pre-2005 generators would be liable for UoS charges in the same way as post-2005 DG, without receiving any further compensation from 2010 for deep connection charges paid. As such, this option may result in some pre-2005 generators notionally paying twice for reinforcement.

4.8. The underlying rationale for this approach would be that the connection charge reflects an arrangement made in the past and that DG (or other parties) have no inherent right to protection from subsequent changes in the industry charging arrangements unless there is an explicit contractual right in this regard. Under this approach, the key question is whether DG customers do indeed have any contractual right that provides protection from changes to industry arrangements. We would need evidence to support any claims to these rights.

4.9. This option may be justified on the grounds that the deep connection charges pre-2005 meant that most generators tended to avoid projects that required reinforcement of the shared network and so charges were usually shallow. We are keen to understand from generators the extent to which this is the case.

4.10. This approach broadly reflects what happened with the change in the demand connection boundary in 2005. We understand that no compensation was paid to demand customers who had paid deep connection charges or who had made up front payment for operations and maintenance costs.

4.11. An alternative argument for not paying compensation is that the exemption in place between 1 April 2005 and 31 March 2010 has already provided compensation to pre-2005 DG and no further compensation is required⁶. We would like to receive any information to help us assess the extent to which the five year exemption applying up until 31 March 2010 has provided sufficient compensation.

Connection charge compensation

4.12. This method would be an adoption of the fairness approach and is aimed at ensuring as far as possible that the generator does not pay twice for any assets or services that were already a component of the deep connection charge. It is implicit in this approach that the generator does not have any generic ongoing rights to use of system as part of its connection agreement with the DNO and that generators are exposed to changes in industry charging arrangements.

4.13. This approach would involve refunding the DG customer with the unexpired portion of their initial connection charge that is deemed now to be recovered through the UoS charges. This is likely to involve determining the portion of the deep connection charge that paid towards network reinforcement and ongoing O&M and running costs. Where it is not clear on the face of the contract, this may also involve agreeing the contract duration.

4.14. One of the main drawbacks of this option is that implementation could be very complex, in particular if information is lacking on the terms of the initial connection and what the connection charge was meant to cover. One way to make it more manageable may be to limit the compensation to DG above or at 10MW. The threshold could be seen as a proportionate solution that limits the effort to a relatively small number of projects. Some DNOs and generators have questioned whether a size limit is appropriate. If this option were to be pursued further, the implications stemming from any threshold (based on capacity requested or voltage level of connection) would need to be carefully considered.

4.15. This option was studied in more detail in 2006 for connections at or above 10MW in order to assess its feasibility. Ofgem presented to the October 2005 ISG meeting the results of information from DNOs on this option⁷. The exercise highlighted some limits to the availability of historical data and that many projects triggered no network reinforcement. Since then, we have encouraged DNOs to

⁶ This idea was first considered in an initial decision document by Ofgem in 2003. Please see paragraphs 5.24 and 5.25 of http://www.ofgem.gov.uk/Licensing/ElecCodes/DistCode/Mods/Archive/5150-Structure_elec_dist_charges_14nov03.pdf

⁷ The presentation is available to view at: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/17110_6_ISG_17October06_G2010_slides_mc.pdf?wtfrom=/ofgem/work/index.jsp§ion=/areasofwork/distributioncharges/edc1

review their contracts and to address any gaps. We are therefore keen to understand whether there are still practical limitations to this approach.

4.16. A variant of the above approach would involve basing compensation on the remaining unexpired value of the upfront payments made for O&M. The rationale for this is that customers typically made a capitalised, upfront payment for O&M as part of their deep connection charge, which would be duplicated as part of a contemporary UoS charge. This may represent a straightforward approach to calculating compensation. Where the duration of the contract is unclear, it may be necessary to deem a standard contract length for the purpose of calculating the unexpired value of the upfront charges made by the generator.

4.17. We note that as part of an approach to calculating compensation that involves looking at the unexpired value of the upfront payments made, it may be appropriate also to take into account the value of the UoS charges the generators have avoided over the 2005 to 2010 period.

4.18. We seek respondent's views on this approach.

NPV of right to UoS

4.19. Several DG customers argue that they have contractual or implicit rights to use the distribution system (either in perpetuity or for a time limited period). For this reason, they consider that the appropriate compensation needs to be based on the net present value of expected future UoS charges. It is unclear to us which elements of the contract provides DG customers with these rights and we invite generators to provide us with evidence - and any legal opinion - they have to this effect.

4.20. We note that if there is not clear evidence that pre-2005 DG has paid for rights to use the system, this approach to compensation would put generators connected post 2005 at a competitive disadvantage. There is also uncertainty as to how compensation calculated on this basis would fit with potentially negative UoS charges.

Other approaches

4.21. We recognise that there are other approaches available. For example, DG customers could be relieved from paying UoS charges until reinforcement is triggered by a new connection or the existing arrangements could be allowed to endure for the remainder of the asset lives of the connections. However, we think that it is important that DG are subject to price signals and we do not think these alternatives are compatible with what we are trying to achieve. We have a strong preference for sorting out compensation arrangements rather than reversing our decision to remove the exemption in one form or another. We welcome views from respondents on whether we should reconsider this position.

Covering the cost of compensation

4.22. In DPCR5 Final Proposals we said that where DNOs can demonstrate that it was appropriate to provide DG with compensation we would allow them to log up this compensation for assessment at DPCR6. This means that the DNOs must record any such compensation and justify to Ofgem that it was warranted. We also said that we would undertake an efficiency assessment at DPCR6 in order to calculate what allowance would be made to DNOs for recovering the costs of paying compensation through an addition to the regulatory asset value.

4.23. Given the different methods considered in this consultation that the DNOs could employ to compensate DG (e.g. a bundled or unbundled approach) there may be different reporting requirements required to ensure that Ofgem has the necessary information to undertake an efficiency assessment at DPCR6. When we have reached a landing on the routes which we think are appropriate, we will work with the DNOs to ensure that they collect and report the necessary information.

4.24. In order to develop the approach that we will adopt as part of the efficiency assessment at DPCR6 we welcome views on the appropriate set of principles that we should adopt to determine when compensation is warranted and the approach that should be used to calculate the level of efficient compensation.

4.25. We recognise that there are some special cases which may not be properly captured by a standard approach to compensation. There may be some contracts where it may not be appropriate for compensation to be paid through the price control arrangements. For example, if DNOs have entered into contracts that grant rights in excess of standard rights, and there is a contractual requirement for compensation above the norm, should all customer pay for this additional compensation through the price control? We would welcome any evidence from DNOs and DG on the number of non-standard contracts that are in force.

HV/LV versus EHV pre-2005 DG customers

4.26. Industry discussions on the need to develop appropriate charging arrangements and principles for compensation have been focused on EHV pre-2005 DG customers. This is in part because HV/LV pre-2005 DG are already charged for UoS in accordance with the CDCM, which took effect from 1 April 2010.

4.27. However, it may be appropriate to consider whether HV/LV pre-2005 DG should also be subject to the same consideration for compensation as EHV DG. We welcome views from respondents as to whether the same compensation principles should apply to HV/LV customers as to EHV customers and whether the same contractual and fairness issues apply.

5. Next steps

5.1. The purpose of this consultation is to seek views on the development of appropriate charging arrangements for pre-2005 DG and to gather views to assist in the development of principles to assess the efficiency of any compensation.

5.2. The consultation is staggered in the following manner:

- The consultation on Chapter 3 issues covering whether the EDCM should adopt a bundled or unbundled approach runs for 4 weeks until 18 August 2010.
- The consultation on Chapter 4 issues covering the principles that should be applied as part of the DPCR6 efficiency assessment of any compensation payments and the consultation in Chapter 2 on contractual arrangements runs for 6 weeks until 1 September 2010.

5.3. All non-confidential responses will be published on our website.

5.4. Once the consultation on Chapter 3 issues has closed we plan to publish a decision setting out a preferred approach for refunding any compensation through an unbundled or bundled approach. We are committed to ensuring that all customers are treated fairly and therefore consider that the DNOs will need to incorporate this decision into their development of the EDCM, which is due to be submitted to us for approval on 1 September 2010.

5.5. We will use the responses to the Chapter 4 issues to help develop our policy on the principles that we will employ at DPCR6. We aim to have these principles fully developed by the time that the EDCM is implemented on 1 April 2011 so that DNOs will fully understand the process to be followed by Ofgem at DPCR6. To help develop these principles we plan to engage with the DNOs and other interested stakeholders to discuss what principles and methods Ofgem should adopt at DPCR6 as part of the efficiency assessment of compensation payments. We will look to set out a timeline for developing these principles at the end of the consultation period once we have assessed respondents' views.

5.6. As part of our consideration of the DNOs EDCM submission, the issue of charging pre-2005 DG is likely to be reviewed further as part of any consultation of the EDCM.

Determinations

5.7. In certain circumstances where a DNO is in dispute with one of its customers over connection or UoS terms or charges, either party can refer the matter to the Authority, which is required to determine on matters where it has jurisdiction to do so. The Authority's determination powers are wide-ranging and sit across various legal instruments. For example, determinations may arise under statute (particularly the Electricity Act 1989) or under the provisions of licences.

5.8. Once a dispute has been referred to Ofgem, we will make a decision regarding our ability to determine in accordance with our defined powers and set out a timetable to ensure its resolution within two months from the receipt of the complaint. The timetable can be reviewed by Ofgem if the complexity of the case requires it or if the parties request an extension in exceptional circumstances.

5.9. We propose to explore with DNOs and DG customers whether the determinations process may be an effective way of considering the detail of select cases. The conclusions drawn may provide useful precedents that could be used for setting out overall principles for renegotiation of contractual terms, so they effectively cover UoS, and for determining and paying compensation. We will discuss this possible avenue with relevant industry parties to assess whether such a process would be beneficial.

New determinations procedure planned

5.10. We conduct determinations in accordance with our published Determinations Procedure, which dates from 2003. In December 2009 we consulted on a number of high level changes we could make to the determinations process, including giving ourselves the right charge for determinations where we think the matter could have been resolved by the parties concerned. Based on consultation responses, a new Determination procedure is currently being drafted which clarifies the alternative dispute mechanisms available to customers and includes guidance on the charging methodology to be applied to customers in those circumstances. As a result, we do not expect that all DG connection contracts would be brought to us for determination and that after the test case determinations had been completed, the need for us to determine would be limited to non-standard contracts, if at all.

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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.

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 18 August 2010 in relation to Chapter 3 and 1 September 2010 in relation to Chapters 2 and 4. They should be sent to:

Nicholas Rubin
Distribution Policy
Ofgem
9 Millbank
London
SW1P 3GE
distributionpolicy@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. As set out in Chapter 5, having considered the responses to this consultation, Ofgem intends to publish a decision setting out preferred approach for refunding any compensation through an unbundled or bundled approach. We will also look to set out a timeline for developing principles for compensation at the end of the consultation period once we have assessed respondents' views. Any questions on this document should, in the first instance, be directed to:

Nicholas Rubin
Manager, Distribution Policy
020 7901 7176
nicholas.rubin@ofgem.gov.uk

Summary of consultation questions

Chapter One

No questions asked

Chapter Two

Question 1: We invite respondents to provide further information they have on contractual arrangements and the extent to which the descriptions in this chapter fit their own circumstances.

Question 2: Do respondents agree with our understanding of the arrangements affecting CVA and SVA customers?

Question 3: Do you consider our summary of contractual issues is accurate and complete?

Chapter Three

Question 1: Have we identified the relevant considerations that influence the decision whether to adopt a bundled or unbundled approach?

Question 2: Do you agree with our minded to position to adopt an unbundled approach for the EDCM

Chapter Four

Question 1: We welcome views on the criteria that should be applied to determine when it is appropriate to pay compensation.

Question 2: When it is appropriate what method(s) should be used to calculate the level of compensation?

Question 3: Do respondents consider compensation to be appropriate in cases where contracts allow for a variation when charging arrangements change? If so, why? Our understanding is that this is the case for all SVA generators and some CVA connected generators.

Question 4: Where contracts are not explicit that UoS charges are included within the terms of the connection, do pre-2005 DG customers have any rights to compensation based on the value of expected UoS charges? What would be the justification for this?

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Question 5: We welcome views from respondents as to whether the same compensation principles should apply to HV/LV customers as to EHV customers and whether the same contractual and fairness issues apply.

Question 6: Are there any other proposals or relevant issues that we have not identified in this consultation that you think should inform our policy development going forward?

Question 7: We would welcome evidence from respondents that would allow Ofgem to assess the potential magnitude of the compensation that might be due under the different approaches that might be adopted to assessing compensation.

Question 8: We welcome views and evidence on the approach that should be adopted in the case of special contracts that grant rights in excess of standard rights and whether any compensation due should all be funded by customers through the price control.

Chapter Five

No questions asked

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 (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010) as well as arising from directly effective European Community legislation.

1.3. References to the Gas Act and the Electricity Act in this appendix are to Part 1 of those Acts.⁸ 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 is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with,

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity;
- the provision or use of electricity interconnectors.

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote

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.

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competition) in which the Authority could carry out those functions which would better protect those interests.

1.7. In performing these duties, the Authority must 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 them¹⁰; and
- the need to contribute to the achievement of sustainable development.

1.8. In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.¹¹

1.9. 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,
- and shall, in carrying out those functions, have regard to the effect on the environment.

1.10. In carrying out these functions the Authority must also have regard to:

- 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.

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 Acts in the case of Electricity Act functions.

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

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

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1.11. The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.12. 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.

¹³ Council Regulation (EC) 1/2003.

Appendix 3 - Glossary

A

Authority

The Authority is the governing body for Ofgem, consisting of non-executive and executive members.

B

Balancing and Settlement Code

A multi-party agreement that sets out the obligations and responsibilities on parties that are participating in the electricity market in Great Britain.

C

CDCM – Common Distribution Charging Methodology

The CDCM is the name given to the common methodology for calculating use of system charges for customers connected to HV/LV distribution systems. It was developed by the DNOs under standard licence condition 50 and was implemented on 1 April 2010.

CVA - Central Volume Allocation

For the purposes of the Balancing and Settlement Code, the method by which energy is apportioned between individual parties connected to either the transmission or distribution systems. Any person may be registered in CVA but BSC Section K 2.1 sets out specific requirements.

D

DCMF – Distribution Charging Methodologies Forum

The DCMF is an industry group run by the ENA that discusses charging developments on the electricity distribution networks. See

<http://2010.energynetworks.org/distribution-charging-methodol/>

DCUSA – Distribution Connection and Use of System Agreement

The DCUSA is an industry code which governs connection and use of system arrangements between DNOs, suppliers and some generators on the distribution networks.

DG - Distributed Generation

Generation which is connected directly to a distribution network as opposed to the transmission network. The electricity generated by such schemes is typically used in the local distribution system rather than being transmitted for use across the UK.

DNOs - Distribution Network Operators

A licensed distributor which operates electricity distribution networks in its designated distribution service areas.

DPCR - Distribution Price Control Review

DNOs operate under a price control regime, which is intended to ensure DNOs can, through efficient operation, earn a fair return after capital and operating costs while limiting costs passed onto customers. Each price control typically lasts five years at a time. DPCR5 is the current price control for DNOs, which commenced 1 April 2010.

E**EDCM – Extra High Voltage Distribution Charging Methodology**

The EDCM is the collective name given to each of the two common methodologies for EHV charging to be developed and submitted by the DNOs on or before 1 September 2010 for approval by the Authority under standard licence condition 50A.

Electricity Act 1989

Electricity Act 1989 c.29 as amended. Also referred to as 'The Act'.

EHV - Extra High Voltage

Term used to describe the parts of distribution networks that are extra high voltage typically consisting of a voltage level of 22kV or more.

ENA - Energy Networks Association

The ENA is a trade association for UK energy transmission and distribution licence holders and operators. Its working groups are developing the charging methodologies. See <http://2010.energynetworks.org>

H**HV/LV – High/Low Voltage**

Term used to describe the parts of the distribution networks typically at a voltage level of less than 22kV.

I**IDNOs - Independent Distribution Network Operators**

A licensed distributor which does not have a distribution services area and competes to operate electricity distribution networks anywhere within the UK.

S**SLC - Standard Licence Condition**

These are conditions that licensees must comply with as part of their licences. SLCs can only be modified in accordance with Section 11A of the Electricity Act. Failure to comply with SLCs can result in financial penalties and/or enforcement orders to ensure compliance.

SVA - Supplier Volume Allocation

The method by which energy is apportioned between Suppliers for the purposes of the Balancing and Settlement Code.

U**UoS Charges**

Charges paid by generators and suppliers for the use of the distribution network.

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