

Rachel Fletcher  
Partner, Distribution  
The Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

1 April 2011

Dear Rachel,

**CDCM approval condition – Generation dominated areas**

On 20 November 2009, Ofgem published its decision to approve the CDCM. This was subject to five conditions, one of which was that the DNOs review the issue of charging generators where the network is or will become dominated by generation. To meet this condition the ENA, on behalf of the DNOs, submitted a report to Ofgem on the 1 September 2010 detailing their findings on the condition's requirements and proposing a further study.

Subsequently Ofgem published its decision in relation to the completion of this condition. At that time you considered that DNOs had not adequately demonstrated fulfilment of the condition, and you asked DNOs to submit a further report that would include:

- A more detailed assessment of the issue.
- Options for developing the CDCM that are subjected to and assessed using detailed cost-benefit analyses.
- A well evidenced conclusion concerning whether change is needed at this stage. A clear timetable of when changes to charging arrangements may be necessary and, in light of this timetable, details of what the DNOs plan to do to ensure the CDCM remains fit for purpose.

To evidence progress on this condition you set revised timescales, including a requirement to submit an interim report by 1 April 2011.

Following your decision the ENA, on behalf of the DNOs, commissioned Frontier Economics to conduct a comprehensive assessment of the case for introducing locational charges for generators connected to the HV and LV tiers of distribution networks.

Frontier Economics have now completed their assessment and have drawn three key conclusions, summarised as:

- There is a strong case against introducing a complex locational charging regime that would derive tariffs for generators connected to both the HV and LV levels at a highly geographically granular level as things stand today.
- There may be a case for introducing a simpler charging regime that derives some form of location based tariff for generators connecting at the HV level.
- Careful consideration should also be given to any advantages and disadvantages that are more difficult to quantify.

In the light of these conclusions Frontier Economics have suggested the following next steps:

- The DNOs should consider how much weight to place on the 'qualitative' concerns about introducing locational generation charges as set out in the report. As noted in the report, these concerns are inherently difficult to quantify, but may be significant, nonetheless.
- Depending on the conclusions the DNOs reach about the significance of these qualitative concerns, they should then consider whether to implement a locational generation charging methodology along the lines of the 'simple' option detailed in the report.
- It should also be noted that our analysis only evaluates the costs and benefits of introducing locational generation charges relative to the existing non-locational charging regime. In the light of this, the DNOs might also wish to consider whether there may be ways of modifying the existing charging regime to achieve some of the benefits associated with locational charges, without actually introducing location-based generation tariffs.

I attach a copy of the Frontier Economics' report, which we believe fulfils the interim requirement.

Following your review of the report, we would welcome the opportunity to discuss with you its content and the conclusions that have been drawn. The DNOs would propose to invite Frontier Economics to take part in this discussion. We believe this will be an important next step, in order that we can fully understand Ofgem's current thinking with regard to both the networks aspects of the report, and its implications for wider energy policy. Your input will help us decide whether to implement changes to the charging methodology at this time.

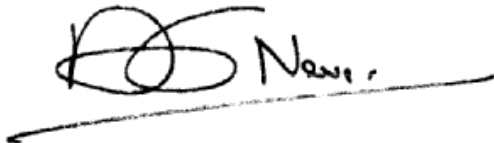
Frontier Economics have agreed to present a summary of their report to industry stakeholders at the DCMF on the 7 April 2011. The DNOs believe that this will be a beneficial opportunity for Ofgem to witness stakeholder

reaction to the findings and we would very much welcome your attendance and input.

Please do not hesitate to contact me if you require any further information.

I look forward to hearing from you.

Yours sincerely,

A handwritten signature in black ink, consisting of a stylized circular flourish followed by the name "Neves" and a long horizontal line extending to the right.

Andrew Neves  
CMG Chair