To generators, distribution and transmission network operators, suppliers and other interested parties

Promoting choice and value for all gas and electricity customers

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Date: 16 November 2012

Electricity distribution charging: Direction by the Authority to approve the charging methodology for higher voltage distributed generation; notice of intention to impose a condition on approval pursuant to Part D of the Electricity Distribution Licence

We have been reviewing the structure of the charges that customers pay for using the electricity distribution network. We aim to ensure that these charges are cost-reflective and are calculated in a common way across Great Britain (GB). This approach will bring benefits, including encouraging customers to make best use of existing assets and reducing the need for reinforcement works that will be paid for by consumers.

As part of this project, the Distribution Network Operators (DNOs)[1] have been developing a common charging methodology for calculating distribution use of system (DUoS) charges for customers that are connected at the higher voltages. The methodology is called the EHV Distribution Charging Methodology (EDCM)[2]. In 2011, we approved the DNOs' proposed EDCM for import (for EDCM demand customers), and this has been used by the DNOs to set charges from April 2012. We deferred our decision on the EDCM for export (for EDCM generation customers). On 1 June 2012, the DNOs submitted to us their revised proposal for the EDCM for export. We published a consultation[3] on the proposal; it ran from 17 August 2012 to 2 October 2012.

This letter:

- explains our decision to approve the proposed EDCM for export[4], subject to the condition[5] that the provision of "super-red" credits[6] for intermittent generators is removed from the methodology before implementation;
- includes a Direction that we intend to impose that condition; it should be satisfied as soon as is reasonably practicable, and by 19 December 2012 at the latest; and
- proposes that the DNOs should, for the charging years after 2013/14, up-rate the operation and maintenance (O&M) rate by an appropriate measure of inflation to ensure that it remains cost reflective.

[1] DNOs are Distribution Services Providers as defined in standard licence condition (SLC) 1 of the electricity distribution licence.
[2] The EDCM is used for all customers that fall within the definition of Designated EHV Properties in SLC 50A.11.
[3] Consultation on charging methodology for higher voltage distributed generation, 17 August 2012, http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=854&refer=Networks/ElecDist/Policy/DistChrgs
[4] Pursuant to SLC 50A.20.
[5] Pursuant to SLCs 50A.21 and 50A.22.
[6] Super-red credits are paid to generators that allow the DNOs to defer network reinforcements and hence reduce costs for consumers. For more detail, see Appendix A to this letter, and our August 2012 consultation.

The remainder of this letter is structured as follows:

- consultation responses;
- our assessment against the Relevant Objectives;
- implementation date;
- process regarding the condition and the changes to the O&M rate;
- setting EDCM charges for 2013/14;
- decision to approve, subject to a condition; and
- summary of responses to our consultation, and our views (at Appendix A).

Consultation responses

We received 15 responses to our consultation. One response was marked as confidential; it broadly supported our position. The other 14 responses were not said to be confidential, and are published alongside the consultation document. Appendix A of this letter provides a list of those organisations, a summary of their responses, and our views on the points that were raised. Broadly speaking, where respondents commented, they supported the DNOs' proposed methodology, and the thinking in our consultation document. Specific topics are discussed in more detail in Appendix A.

Our assessment against the Relevant Objectives

Our approval is on the basis that, having regard to our principal objective and duties under the Electricity Act 1989, the EDCM for export charges achieves in the round the Relevant Objectives set out under the licence[7]. We outline more specifically some of our reasons against the Relevant Objectives below.

50A.7 The first Relevant Objective is that compliance with the EDCM facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence.

- We consider that the EDCM for export charges facilitates the licensees' obligations under the Act and the licence. In particular:
    - section 9(1) of the Act, which places a duty on DNOs to develop and maintain an efficient, co-ordinated and economical system of electricity distribution; and
    - SLC 50A of the licence which concerns the development and implementation of an EHV Distribution Charging Methodology.

50A.8 The second Relevant Objective is that compliance with the EDCM facilitates competition in the generation and supply of electricity and will not restrict, distort, or prevent competition in the transmission or distribution of electricity or in participation in the operation of an Interconnector.

- Having a common methodology across GB should encourage competition by reducing barriers to entry for suppliers and Licensed Distribution Network Operators (LDNOs)[8] operating in multiple DNO areas. They will now only have to understand a single charging methodology (with the exception of the method used to calculate the locational credits[9]) for export charges.

- The payment of super-red credits to generators that bring network benefits can encourage new entrants into the generation market. The common approach across GB will make it easier for new entrants to choose optimal locations.

[7] SLC 50A.7 to 50A.10.
[8] LDNOs are independent DNOs (IDNOs) and DNOs operating out of area.
[9] There are two versions of any EDCM model: for the locational calculations, some DNOs use the LRIC method, and the other DNOs use the FCP method; the two models are identical in all other respects.

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50A.9 The third Relevant Objective is that compliance with the EDCM results in charges which, so far as is reasonably practicable after taking account of implementation costs, reflect the costs incurred, or reasonably expected to be incurred, by the licensee in its Distribution Business.

- Charges are dependent on generators' agreed capacity, and the sole-use network assets used; credits are dependent on generators' exported power at system peak, and the network assets used. Calculating charges and credits based on such cost drivers helps to ensure that they appropriately reflect the costs imposed (and the benefits provided) by generators on the network. In particular, the credits reflect the estimated future savings of deferring reinforcement of the network used by the demand customers. These credits are higher in parts of the network that have congestion that is caused by demand, and lower (or zero) in less congested parts of the network, reflecting the estimated savings for demand customers as a result of generators locating in those areas. Overall, we consider that the methodology has taken a proportionate approach to cost reflectivity.

50A.10 The fourth Relevant Objective is that, so far as is consistent with the first three Relevant Objectives, the EDCM, so far as is reasonably practicable, properly takes account of developments in the licensee's Distribution Business.

- Specific arrangements have been made for customers connected to LDNOs' networks, reflecting the increased prevalence of LDNOs.

- The locational credits signal to new generators to connect in areas where their export can help to meet local demand. In light of the significant amount of reinforcement estimated to be required in the networks (£2.2 billion over the DPCR5 period, of which £1.6 billion is at EHV), and of the forecasts of future penetration of distributed generation, these behaviours help to ensure more efficient investment and ultimately lower bills for customers.

As discussed in our consultation of August 2012, we recognise that the introduction of the EDCM for export will result in higher charges for some generators. Some generators that were connected on or after 1 April 2005 and that currently pay DUoS charges will see an increase in their DUoS charges. Some generators that were connected before that date (pre-2005 generators) will pay DUoS charges for the first time. However, we remain of the view that it is in the interests of consumers and of the majority of higher voltage generators for the DNOs to implement a common charging methodology as soon as possible. Our consultations and the DNOs' engagement have provided notice that these changes were likely; and we have delayed the project previously, partly to allow further time for discussions with the most affected customers.

Even though we intend to impose the condition that the provision of super-red credits for intermittent generators is removed, we consider it could be appropriate in the future to provide super-red credits to intermittent generators. As discussed in Appendix A, we would expect any such change to be driven by an amendment to the planning standard to take account of any relevant benefits that intermittent generators provide. We also ask that the DNOs provide clear and consistent information to customers and suppliers about how they define intermittent generation in relation to the planning standard.

Implementation date

The implementation of the EDCM for export was deferred from 2011 because we asked the DNOs to resubmit the methodology with certain improvements. We think that deferring it again would unnecessarily defer the benefits that its implementation would bring. The introduction of the methodology will improve the cost reflectivity of charges and encourage more efficient use of network assets, to the benefit of consumers. It will

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also reduce charges for around 90 per cent of those higher voltage customers that currently pay export charges.

Our consultations, and the engagement by the DNOs, have provided notice to customers that the introduction of the new methodology will cause changes to their charges. In our decision letter of 20 December 2011[10], we said that the implementation date for the EDCM for export would be 1 April 2013. We have maintained this position. **The DNOs should use the EDCM for export to set their export charges for the charging year 2013/14 onwards.** They must use it to set the indicative charges in December 2012 for the year from 1 April 2013, and then the final charges in February 2013 for the year from 1 April 2013.

The DNOs produced three scenarios to help customers to understand the consequence of different decisions by pre-2005 generators. We recognise that our decision to disallow super-red credits for intermittent generators will affect the net payments or credits for some intermittent generators. Some pre-2005 intermittent generators that were eligible for exemptions might have opted into the EDCM for export in the expectation of receiving a net credit, but would now pay a net charge. The DNOs should urgently contact these customers and give them the option to reconsider the decision.

Process regarding the condition and the changes to the O&M rate

The 28 day period for making representations or objections with respect to the condition is the minimum period required by the licence condition. Subject to any representations or objections from DNOs, we would then issue a decision to impose the condition, stating the date by which it had to be satisfied. We have stated in this letter that the date is 19 December 2012; we discuss this below. The process from 16 November 2012 is as follows:

- the DNOs make any representations or objections to our notice of intention;
- subject to the DNOs responses, we issue our decision to impose the condition;
- the DNOs submit evidence that they have satisfied the condition (including the revised methodology, the revised model, and a short explanatory note);
- we assess that evidence and issue a decision on whether the condition has been satisfied; and
- if the condition has been satisfied, then the DNOs then use the revised methodology for setting charges.

However, we note that the DNOs would like to have a decision as soon as possible on whether they can use the EDCM for export, and by 5 December 2012 at the latest. This would allow them to use the EDCM for export for setting indicative charges in December 2012 for the year 2013/14. This timing is possible. **We ask that all of the DNOs respond as soon as possible to this notice of our intention to impose a condition, including if the response is to say that a DNO does not wish to make any representations or objections**.

The date of 19 December 2012 is the nearest date that we think would be achievable if we had to wait the full 28 days to know whether or not any DNOs wanted to made any representations or objections. However, if we were to receive all of the DNOs’ responses early within the 28 day period, then we could take the appropriate next steps before the 28 day period has expired, and the decision on the condition could be made by 5 December 2012.

As discussed in Appendix A, we propose that the DNOs should, for the charging years after 2013/14, up-rate the O&M rate by an appropriate measure of inflation. This is not

[10] Decision on revised timetable for modification to the EHV Distribution Charging Methodology (EDCM) for export charges and deferral of boundary for export customers, 20 December 2011, http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=812&refer=Networks/ElecDist/Policy/DistChrgs

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a condition of our approval, and the change can be made after implementation of the methodology. The EDCM for export should be put under the open governance of the Distribution Connection and Use of System Agreement (DCUSA), which allows changes to be proposed by any party to the agreement. The DNOs should address the issue with the O&M rate through the DCUSA open governance process.

Setting EDCM charges for 2013/14

This letter and Direction is concerned with the EDCM for export. It does not concern the EDCM import methodology that we approved in 2011, and which is under DCUSA open governance. The DNOs presented the EDCM for export to us on 1 June 2012; they then also presented a combined model on 11 July 2012 that calculates charges for import and export. The export part of the combined model is identical to that submitted on 1 June 2012; therefore, by approving the export EDCM methodology as submitted on 1 June 2012, we are also approving the export part of the combined model. The import part of the combined model gives the same results, to a high degree of accuracy, as the import model that is in the DCUSA. The DNOs propose that, subject to our approval of the EDCM for export, the combined EDCM model should be put under DCUSA open governance. We consider that this is appropriate, although our decision would be subject to the correct governance processes. This combined model would replace the EDCM import model that is under DCUSA open governance.

However, that process of putting the combined model under the DCUSA might not happen in time for the DNOs to set indicative charges in December 2012 for 1 April 2013. The DNOs must use the version(s) of the methodology as stipulated in the relevant licence conditions and/or the DCUSA document. If this means using two different models (one for import charges and one for export charges), then the DNOs should ensure that the input data are treated consistently.

Decision to approve subject to a condition

Having regard to the Relevant Objectives and its principal objective and duties under the Electricity Act, the Authority hereby directs that the EDCM for export be approved pursuant to Part D of the electricity distribution licence. This is subject to the condition that the provision of "super-red" credits for intermittent generators is removed from the methodology as soon as reasonably practicable and by 19 December 2012 at the latest.

The DNOs have a period of 28 days (up to 14 December 2012) within which to make any representations or objections with respect to this condition.

This letter contains the reasons for Authority's decision pursuant to section 49A of the Electricity Act.

If you would like to discuss any aspect of this work, please contact Simon Cran-McGreehin (e-mail: Simon.Cran-McGreehin@Ofgem.gov.uk, tel: 020 7901 7440).

Yours faithfully,

Andy Burgess

Andrew Burgess
Associate Partner, Transmission and Distribution Policy

For and on behalf of the Gas and Electricity Markets Authority

16 November 2012

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Appendix A: Summary of responses

We received 14 non-confidential responses to our consultation, from the following organisations:

- four were from network companies, or a representative body:
    - Northern Power Grid (NPG)
    - UK Power Networks (UKPN)
    - Western Power Distribution (WPD)
    - The Common Methodologies Group (CMG)
- seven were from developers / generators, or representative bodies:
    - RWE npower renewables
    - Scottish Power Renewables (SPR)
    - Solar Securities
    - ESBI
    - Renewable Energy Association (REA)
    - Renewable Energy Systems (RES)
- two were from companies with interests in supply and generation:
    - British Gas (BG) / Centrica
    - EDF
- one was from a Scottish Government agency:
    - Highlands and Islands Enterprise (HIE)

This Appendix sets out a summary of the responses that we received to our consultation, and also our views on the comments. We have grouped questions together by topic, and have covered each topic in a separate section, below.

<u>*Provision of information*</u>
Chapter 1, Question 1: Have the options available to pre-2005 generators been clearly explained to those generators?
Chapter 1, Question 2: What information (or guidance) about the EDCM would be of use to industry participants, and what do DNOs and generation customers think could be provided?

It is important that EDCM customers are informed about issues that could affect their DUoS charges. During the transition to a common, GB-wide methodology, it has been important for the DNOs to involve their customers, and to inform them of the potential impacts upon charges. In particular, generation customers with pre-2005 connections will be subject to DUoS charges for the first time; some of them will be eligible for a 25 year exemption, and those customers will have the choice whether to waive their exemptions. We asked whether the options had been clearly explained (Ch.1, Qu.1). Generally, respondents felt that the options had been explained to pre-2005 generation customers, but some potential improvements were identified.

Five respondents did not comment, seven said that the options had been explained, and three said that the information had been provided, but that there could have been improvements. One said that some forecast charges had varied significantly between late 2011 and June 2012, and that it was not clear to them if this was due to changes to the proposed methodology or changes to input assumptions. Another said that some communications from the DNOs had been sent to the wrong recipients. The third said that Ofgem's August 2012 consultation had confused the issue.

We also asked about what information regarding the EDCM could be useful to, and could be released to, industry participants (Ch.1, Qu.2). Four respondents felt that sufficient information was provided to customers, e.g. through bilateral discussions requested by individual customers, but would welcome suggestions for improvement. Nine made points about improving the provision of information about the EDCM. Some customers and suppliers want to have more notice of charges, several years in advance if possible. Some would like access to the EDCM model, but there was acknowledgement that some of the data is confidential. Most requested that the DNOs provide more data to customers and suppliers on an annual basis, to give more certainty over charges for future years. One was concerned that lack of complete data for customers meant that they could not respond to the locational signals of the EDCM. One requested an explanation of the scope that the DNOs have for reductions in DUoS charges. Another asked that DNOs provide charging data to potential customers earlier in the project development process.

We have sought to allow sufficient time for the development of the EDCM for customers to receive notice of potential changes to their charges. We recognise that the DNOs have had to notify customers of a number of different potential charges, and that our potential condition to disallow super-red credits for intermittent generators introduced another permutation for some generators. By publishing our decision now, the DNOs will be able to take this into account when providing their indicative charges for 2013/14 in December this year.

Issue 1: Super-red credits for intermittent generators
Chapter 2, Question 2: Do you agree with our understanding that the interactions between super-red credits for intermittent generators and Engineering Recommendation P 2/6 could result in demand customers paying for credits when no network benefit is recognised under the planning standard?
Chapter 2, Question 9: Is it appropriate for us to place the potential condition that we have suggested, and are there any other conditions that respondents feel would help to better meet the Relevant Objectives?

Under the EDCM for export, credits would be paid to generators that defer demand-led network reinforcement. The rationale is that, if a generator helps to meet peak demand in its "local area", then less capacity is needed between those demand customers and other generators. This reduces costs for demand customers, and so it is appropriate that they pay credits to such generators when they produce at times of peak demand. The DNOs proposed that intermittent generators should be eligible for partial credits. Full credits would be inappropriate because intermittent generators cannot be relied upon to produce at any particular time, and so they do not allow the DNOs to defer any local reinforcements. Therefore, the DNOs propose they should not receive "local credits". However, the DNOs state that intermittent generators do, on aggregate, defer some network reinforcement at higher network levels, and so should receive a partial "remote credit". In our consultation of May 2011[11], we said that this approach could be appropriate. However, we noted in our consultation of August 2012 that the planning standard (Engineering Recommendation P2/6[12]) might not recognise the same benefits from intermittent generators. The result would be that demand customers would pay for the partial credits and also for network reinforcement; the rationale for credits means that they should pay for one or the other, but not both.

We asked if respondents agreed with our understanding of the interactions between the EDCM credits and P2/6 (Ch.2, Qu.2). Three respondents agreed with our understanding, and said that the resulting payments from demand customers would be inappropriate. One of them said that credits could be useful in the future for encouraging intermittent generation to employ energy storage. A further seven agreed with our understanding,

[11] Electricity distribution charging methodologies: distribution network operators' (DNOs') proposals for the higher voltages, 20 May 2011, http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=687&refer=Networks/ElecDist/Policy/DistChrgs
[12] Engineering Recommendation P2/6, Security of supply, July 2006; available from the Energy Networks Association

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but felt that it was still appropriate to pay the partial credits. Several respondents noted that an update of the P2/6 planning standard was required. One noted that the planning standard is not under open governance, and that changes could be subject to inertia.

Three disagreed with our understanding: one said that intermittent generators should receive full credits, another that the proportion of credit paid should be calculated on a site-by-site basis, and the third that further consultation was required to resolve the issue. Two did not have a view.

We asked whether it was appropriate for us to place a condition on our approval, namely that intermittent generators should not receive super-red credits (Ch.2, Qu.9). Five respondents supported the imposition of the potential condition. Eight respondents opposed it. Two opposed it because they disagreed with our understanding of the issue. Two opposed it primarily because they felt that there were merits in giving partial credits despite the interactions with P2/6. Three made points about the process, including that the issue could be addressed through DCUSA open governance, and that a condition might delay the implementation of the EDCM for export. Two respondents expressed no view.

We appreciate that the DNOs have undertaken this work in response to comments in our May 2011 consultation, and we note that they have developed their proposed approach with input from other industry participants. However, we remain of the opinion, as set out in our August 2012 consultation document, that it would be inappropriate to implement the DNOs' proposal at this time, because it could lead to demand customers paying for both partial credits and for network reinforcements. Therefore, as part of this decision, we are placing a condition on our approval of the proposed EDCM for export, namely that super-red credits must not be paid to intermittent generators.

However, the DNOs' proposal approach could be appropriate in future, if there was no risk of demand customers paying both for credits and for reinforcements. We expect that this would require any proposal to be compatible with the relevant planning standards. We note that work is ongoing to produce planning standard P2/7, a successor to P2/6. It is anticipated that the EDCM for export (as part of the joint EDCM for import and export) will be incorporated into DCUSA open governance at the earliest reasonable opportunity. Once that has been done, any changes to the EDCM could be proposed through the open governance process, and this would be subject to a final decision by Ofgem.

Issue 2: Sole use assets
Chapter 2, Question 3: Is the treatment of sole-use asset costs appropriate?

It is necessary to allocate the non-capex costs (direct operating costs and network rates) associated with each generator's sole-use assets. The DNOs proposed to allocate those costs to each generator, and to do so through a fixed charge (p/day). The approach is the same as that which we have approved for EDCM demand customers, and the DNOs have proposed an approach that avoids double charges for mixed (generation and demand) sites. We thought that the proposed approach was appropriate, and asked for views (Ch.2, Qu.3).

Three respondents made no comment. Eight agreed with us, and three more agreed but with caveats. One of the three said that it was appropriate to identify how the replacement of such assets will be funded; we note that the question of asset replacement costs has been considered during the development of the CDCM and the EDCM. Another of the three said that the DNOs should publish sufficient information so as to allow developers to estimate the fixed charge before committing to a generation project; we agree that it would be beneficial for the DNOs to provide potential customers with more information when appropriate. If industry participants think that improvements could be made in either of these areas, then any such proposals can be progressed through the DCUSA open governance process.

The third respondent to support our view but with a caveat, said that some pre-2005 generators have already paid capitalised O&M charges for sole use assets, and so should be exempt form that charge even if they opt in to EDCM charges. Historically, the DNOs have used a variety of approaches for determining customers' charges; to account for every case would make a common methodology extremely complicated. We think that our decisions concerning pre-2005 generators strike the correct balance between cost-reflectivity and simplicity, and we do not intend to exempt any pre-2005 generators from some costs and not others. These pre-2005 generators with unexpired O&M payments are eligible for an exemption and will therefore automatically avoid these O&M charges unless they decide to opt in to the charging methodology.

One respondent opposed the proposal. It said that the methodology for calculating the charges was unclear. It also said that DNOs should provide sufficient information early enough for developers to assess the impact of the charges, and that the charges should be capped for solar developers. As above, we agree that it would be beneficial for the DNOs to provide potential customers with more information earlier in the development process. On the question of capping charges for solar generators, we do not think that this is appropriate as it could dampen incentives for generators to locate in areas that minimise costs for consumers and would also distort competition in the generation market. However, the respondent might wish to discuss this with the industry, and could propose changes through the open governance process.

Having considered the responses, we have maintained our view that the DNOs have proposed an appropriate approach to allocating the non-capex costs associated with sole-use assets.

<u>Issue 3: Revenue pot</u>
Chapter 2, Question 4: Is the calculation of the revenue pot appropriate, in particular the approach to the DPCR4 contribution, and proposed figure for the O&M rate?
Chapter 2, Question 5: Is the approach to allocation of the revenue pot appropriate?

Some assets are used by more than one customer, i.e. they are shared assets. The DNOs proposed a method for determining the size of the revenue pot, i.e. the total costs (capex, and the O&M part of opex) that can be attributed to the use of shared assets by EDCM generators. A key part of that calculation is setting the value of the O&M rate, for which the DNOs proposed a value of £0.20/kW per year. The DNOs have also proposed a method of allocating these costs between EDCM generators, i.e. the calculation of the capacity charge (p/kVA per day).

We asked whether the calculation of the revenue pot is appropriate, in particular the approach to the DPCR4 contribution, and the proposed figure for the O&M rate (Ch.2, Qu.4). Six respondents made no comment, and none were opposed to the proposal. Six supported the proposal, and a further three supported it but with caveats. One of them said that the proposed O&M rate of £0.20/kW should be index-linked, so that it would be up-rated by inflation each year. It also queried the difference between that value and the £1.00/kW that the DNOs receive through the price control, as we had noted previously. Another questioned whether reducing the total EDCM generation charges and moving costs onto CDCM customers makes the CDCM less cost-reflective, and also queried whether exempt generators are subsidised by those customers (whether demand and/or generation) that do pay EDCM charges. No alternative approach has been proposed.

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The third respondent to support the proposal but with caveats said that many pre-2005 generators paid O&M as a capitalised sum, and so none of them should pay the O&M component. It also said that the explanation of the O&M costs for those generators was unclear. The point that we were making in our consultation document was that, while a pre-2005 generator is exempt from EDCM charges, it will contribute no costs to the revenue pot; but when it does pay EDCM charges, the only cost that it will contribute to the revenue pot is the O&M component. As noted above, we think that our decisions concerning pre-2005 generators strike the correct balance between cost-reflectivity and simplicity. These pre-2005 generators with unexpired O&M payments are eligible for an exemption and will therefore automatically avoid these O&M charges unless they decide to opt in to the charging methodology.

We asked whether the approach to allocation of the revenue pot is appropriate (Ch.2, Qu.5). Seven respondents made no comment, and none were opposed to it. Six supported the proposal, and a further two supported it but with caveats. One of these said that the approach was appropriate, but that an alternative would be to split each DNO's allowed revenue between demand customers and generation customers, although no further details were provided. The other said that its view depended upon the answers to its queries about moving costs onto CDCM customers, and about whether exempt generators are subsidised by those customers that do pay EDCM charges.

We maintain our view that, based on the evidence provided by the DNOs, their proposals for the revenue pot seems reasonable. Therefore, we approve the DNOs' approach to the calculation and allocation of the revenue pot. If stakeholders feel that an alternative should be considered in more detail, or if they wish to consider other issues further, these can be raised at the DCMF, and through the DCUSA open governance arrangements, taking into account interactions with the development of the RIIO-ED1 price control.

<u>*Issue 4: LDNO charges*</u>

Chapter 2, Question 6: Do you have any views on the calculation of LDNO charges through the extended "Method M" for CDCM-like customers, and through the separate methodology for EDCM-like customers?

The DNOs' proposed methodology calculates charges for an LDNO that has a distribution network that qualifies as a designated EHV property. We asked for views on the proposed approaches to these calculations, including whether it is appropriate that there would be no LDNO discounts (Ch.2, Qu.6). Twelve respondents had no comment, and two were supportive. A further respondent was supportive but with caveats. It said that the DUoS charging arrangements make generation network economically unattractive for IDNOs. It said that it is unclear what charging methodology should be used for calculating the EHV DUoS charges of end customers connected at EDCM network tiers. It also said that there are anomalies in the way that EHV costs are treated in the charging models, but that it was not clear whether improvements would be sufficient to make generation network attractive to INDOs. However, the respondent said that we should approve the methodology. As we noted in our August 2012 consultation, we expect the DNOs to keep the methodology under review to ensure that LDNOs are fairly treated and receive appropriate discounts.

<u>*Impact assessment*</u>

Chapter 2, Question 10: Do you think that we have identified the important impacts in our Impact Assessment?

We presented our assessment of the impacts of implementing the DNOs' proposed methodology. We asked if we have identified all of the important impacts (Ch.2, Qu.10).

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Seven respondents did not comment, and six said that we had identified all of the relevant impacts. The remaining two respondents identified areas that were not included. One said that there was no analysis of the overall economic impact, but that this was not a major issue because it was self-evident that introducing a more cost-reflective methodology should produce an overall economic gain. The second said that the three scenarios provided by the DNOs did not adequately reflect the likely conditions for generators, and that the analysis did not consider the behavioural impacts upon generators.

An underlying principle in developing this methodology is that cost-reflective charges will encourage efficient behaviour. We feel that there would have been limited benefit in us trying to model detailed behavioural changes by generators and to do so would not have been proportionate given the complexities involved. Our intention was to assess the potential impact upon charges of introducing the proposed EDCM for export. We used data provided by the DNOs to compare the charges that are currently being levied in 2012/13 with the illustrative charges, i.e. those that would have been levied in 2012/13 had the EDCM for export been in use. We and the DNOs have pointed out that these illustrative charges should not be viewed as forecasts for charges in 2013/14. Also, data confidentiality meant that we could not publish detailed information about individual customers. As we noted in our August 2012 consultation, customers should work with their DNOs in order to understand the likely impacts upon their charges.

<u>*Further points*</u>
Chapter 2, Question 1: Do you think that the proposed methodology includes the relevant issues, and has not omitted any relevant issues?
Chapter 2, Question 7: Do you have any other comments about the issues that we have noted, or about any other points?

We asked respondents whether they had any other comments about the issues that we noted, or about any other points (Ch.2, Qu.7). No respondents had any other comments on the issues that we had raised, beyond those made in response to specific questions, as discussed above.

We also asked respondents whether the proposed methodology includes the relevant issues, and whether it has omitted any relevant issues (Ch.2, Qu.1). Four respondents did not comment, and eight said that it covered all of the relevant issues with no omissions. One respondent asked for clarification about the classification of hydro storage schemes. We ask that the DNOs provide clear and consistent information to customers and suppliers about how they define intermittent generation in relation to the planning standard.

Two respondents raised points that they felt should be included in the methodology. The first said that the proposed methodology would affect the competitiveness of generators larger than 100MW that are connected to the distribution network. The reasoning is that they would pay DUoS charges and also transmission use-of-system (TNUoS) charges, whereas a similar generator connected the transmission network would pay only TNUoS charges, and a smaller generator connected to the distribution networks would pay only DUoS charges. We do not see this as a concern, if a generator uses both networks because of its size then we think it should be pay appropriate cost reflective tariffs for each network. We see these signals as being desirable in encouraging efficient behaviour.

The second raised concern about lack of information for customers making it hard to respond to locational signals (discussed under Ch.1, Qu.2). It also made a point about generation side management (GSM) agreements. The DNOs said that no element of the charges is linked to costs that could be avoided by a temporary reduction in the capacity

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used by a generator, and hence they proposed that GSM agreements should not result in lower EDCM charges. The respondent said that more information is needed about the eligibility and criteria for GSM agreements. We note that the DNOs said in their report of 1 June 2012 that "no reduction in EDCM charges under a GSM agreement can be justified", and that "[t]he EDCM proposals do not affect the terms of any existing GSM agreement". We ask that the DNOs provide further clarity on this point for customers that have (or are considering) a GSM agreement. We expect the DNOs to keep this area under review and to introduce appropriate GSM agreements if a sound basis can be found to do so.

Approval and conditions

Chapter 2, Question 8: Is it appropriate for us to approve the methodology?
Chapter 2, Question 9: Is it appropriate for us to place the potential condition that we have suggested, and are there any other conditions that respondents feel would help to better meet the Relevant Objectives?

We asked whether it is appropriate for us to approve the methodology (Ch.2, Qu.8). Five respondents did not comment directly on this question, nine said that we should approve the proposed methodology. None said that we should not approve the methodology, but one did reiterate its view that the proportion of super-red credits to be paid should be considered on a site-by-site basis.

We also asked whether it is appropriate for us to impose the potential condition that we have suggested (i.e. that there should be no super-red credits for intermittent generators), and whether there are any other conditions that would help to better meet the Relevant Objectives (Ch.2, Qu.9). As discussed above, respondents' views on this matter were split. Five supported the use of this potential condition, including suppliers and generators. Eight opposed the use of this potential condition, including three DNOs, two generators, two renewables organisations, and Scottish Government agency. However, we note that, of these eight, only three disagreed with our understanding of the interactions between the P2/6 planning standard and super-red credits for intermittent generators. The other five agreed with our understanding, but cited reasons why they felt that the super-red credits should still be paid to intermittent generators.

Two respondents proposed other conditions for our approval. One suggested that we impose a condition to uplift the proposed O&M rate with inflation each year to help maintain its cost reflectivity, as discussed above (Ch.2, Qu.4). Our view is that it is appropriate for the O&M rate to be up-rated each year by inflation. However, we have decided that this does not warrant a condition to our approval. The DNOs should address the issue with the O&M rate by raising a modification proposal for consideration by the DCUSA members and Ofgem. The other respondent to propose another condition suggested that we impose a condition to place a cap on charges for sole-use assets for small solar PV generators, as discussed above (Ch.2, Qu. 3). As noted above, we do not feel that this is appropriate.

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