

Distribution Network Operators,
DCUSA Parties, distributed
generators and other interested
parties

Date: 7 November 2014

Electricity Distribution charges in generator dominated areas: Consultation on our 'minded to' position to reject a proposed change to distribution charges (DCP137)¹

This letter sets out the reasons why we are currently minded to reject DCP137. This modification proposes to change the way we calculate distribution charges under the Distribution Connection and Use of System Agreement (DCUSA), by introducing locational tariffs for certain generators connected to distribution networks. We are seeking your views on the issues discussed in this letter to help us make sure that we have fully considered these before reaching our final decision. The deadline for responses is 9 January 2015. See below for details on how to respond to this consultation.

Background to the modification

Since 2010-11, the distribution network operators (DNOs) have charged for use of their distribution networks on a common basis. For the vast majority of those connected to the distribution network as customers or generators, the rules setting out the common basis for charging are found in the Common Distribution Charging Methodology (CDCM).

One of the principles in the CDCM is that generators located in an area where demand is high should receive benefits through credits. This is because their connection may allow the DNOs to defer or avoid some infrastructure investment (network reinforcement) that otherwise would be needed for connected demand. However, it is possible that if there are enough generators in an area, they may drive a need **for** costly investment, rather than potentially deferring or removing the need for it.

When we approved the establishment of the CDCM in 2009, we set out certain conditions the DNOs needed to fulfil, including where they might need to charge generators in a situation where generators trigger network reinforcement.

The DNOs commissioned Frontier Economics to investigate the issue of generation dominance, resulting in a report that was submitted to us by the DNOs in 2011. The main findings of the report were that:

- there is a strong case not to introduce a highly complex locational charging regime to address generation dominance;
- there may be a case for a simpler charging regime limited to High Voltage (HV) generation; and

¹ 'Introduction of Locational Tariffs for the Export from HV Generators in Areas Identified as Generation Dominated'

- careful consideration needs to be paid to the advantages and disadvantages that are more difficult to quantify.

For this last concern, Frontier Economics' report outlined the issues of:

- whether suppliers would pass the costs on to generators;
- the potentially negative effect locational charging could have on the simplicity, transparency and predictability of charges; and
- the interaction of locational charges with other energy policies (eg the risks of reducing generation growth even in demand-led areas, which could affect the achievement of 2020 renewables targets and may create a barrier to entry with locational charging).

The CDCM is part of the DCUSA² and is therefore subject to change through open governance. Following receipt of the Frontier Economics report, the Methodologies Issues Group (MIG)³ developed the issue further⁴ with the intention of raising a possible DCUSA change proposal, based on option 3 suggested in the Frontier Economics report.⁵

DCP137 change proposal

DCP137 was proposed by Electricity North West Limited. As part of the development of the proposal, the working group issued consultations with stakeholders. The Frontier Economics report defined generation dominance to mean, "a primary substation where thermal reinforcement is more likely to be caused by generation than demand within a specific time period". The working group chose to build on this definition with a second test, (to create their "two test" methodology), to validate whether generation loading is higher than demand loading, ie confirming generation dominance over local demand.

The working group's reasons for considering the issue of generation dominance were:

- Generation currently receives credits on the basis that generation provides a benefit to the system by offsetting or deferring costly network reinforcement.
- At present, the CDCM offers a p/kWh credit to connected generation customers, irrespective of where they are located on the network. In addition to the credit, a fixed charge (p/MPAN/day) or reactive charge (p/kVARh) may also apply.
- Where generation ceases to provide a benefit (and in fact could trigger reinforcement), credits should be reduced or removed.

The working group proposed to address generation dominance by:

- Establishing how generator dominated areas (GDAs) would be defined and designated and assessing the level of generation dominance there is, ie. a "two test" methodology.⁶
- Introducing a location-variable regime to reduce credits to those HV generators exporting to primary substations in areas defined as generation dominant (these would also vary depending on the level of generation dominance).

² The CDCM is found in Schedule 16 of the DCUSA (see: <http://www.dcusa.co.uk/SitePages/Documents/DCUSA-Document.aspx>)

³ This is a group where issues regarding charging methodologies can be raised and developed prior to a modification being raised with DCUSA.

⁴ See the MIG GDA report on generation dominance included with the supplementary documentation for this consultation

⁵ The Frontier Economics report outlined three high-level locational charging options ie: Option 1- complex option with high granularity and applied to HV and LV; Option 2 - intermediate option with moderate level of granularity at primary substation level and applied to HV and LV; Option 3 - simple option, similar to intermediate option but applied to HV only and at a primary substation level. See page 41 of the report for further details.

⁶ Test 1 - considers the summer minimum demand test-ie to see what the maximum generation demand is compared to the minimum capacity of the local substation. Test 2 - compares maximum demand and maximum generation at the substation, to confirm that generation is dominant over local demand.

- Restricting this new regime to HV generators as the workgroup assumes that generation from Low Voltage (LV) generators will be absorbed locally before burdening local distribution assets.

Reasons for our minded to position

On 10 September 2014, we received the DCP137 Change Declaration recommending that we approve DCP137. The DCUSA parties that voted on DCP137 recommended approval of the modification but rejected the proposed implementation date of 1 April 2015.

We have reviewed the DCP137 Change Declaration, the accompanying papers, industry responses to the two DCP137 working group consultations and the outcome of the DCUSA parties' vote. In assessing this change, we will have regard to, among other things, our principal objective to protect the interests of consumers and the need to ensure that companies have sufficient certainty to make long-term investment decisions, to provide reliable supply of energy.

We agree with the working group's considerations underpinning this modification. However, this modification may have an impact on existing generation as the proposed change intends to use forecast data to reduce existing credits. Existing generation which, as the working group acknowledges, provides a benefit by offsetting demand until reinforcement may be needed, will lose credits because of forecast new generation connecting in future. We note that the second part of the "two test" methodology is intended to ensure that this benefit in offsetting demand-led reinforcement is protected. However, it is unclear whether this will be sufficient where the reduced credits will affect existing generation. Existing generation may also change its behaviour, potentially leading to less benefit.

We have concerns about how this change will affect the growth of renewable generation where there is often less scope for choice of connection location. We consider that this change may have an impact on generator behaviour in areas that are not currently generator dominated. Therefore, we would like updated views on whether this change may have a behavioural impact on existing and future generation. We are also concerned that there is no provision for correction or retrospective action on credits should reinforcement not materialise, or where an area has been incorrectly identified by the DNOs as generation dominated.

Furthermore, this modification may affect the balance between generation growth and demand growth. Generation growth is more sensitive to such a locational signal, which may then mean that the benefit provided by generation in deferring demand-led reinforcement may be lost in certain areas. We note that the Frontier Economics report and work done by the MIG has assumed that generation provides this benefit. We note, however, that Frontier Economics referenced the effect locational charges may have on generation growth in demand-led areas and in meeting GB's renewable 2020 targets. Both of these would rely on healthy generation growth to offset both carbon and demand growth.

The responses to the two consultations carried out by the working group, particularly by generators, have raised some concerns regarding the impact of the change on both competition and cost-reflective charges.⁷ We would like to understand if stakeholders have updated views on these concerns and potential alternatives, given the lapse of time between the two consultations. There has also been significant growth in distributed generation since the work leading to the parties' recommendation on this modification was

⁷ The work group consider their change proposal better meets DCUSA charging objectives 2 and 3, clauses 3.2.2 and 3.2.3. The change is considered to better facilitate **competition** by facilitating more cost reflective charges for generation. The change is considered to be more **cost-reflective** by removing or reducing HV generators from exporting capacity through primary substations—so tariffs will be more reflective of costs incurred by DNOs in running their network.

undertaken. We are interested in whether this has had an impact on views. We also understand that there is currently no clear example of generation dominance on which to base the need for this change at present. We therefore question whether it may be premature to make such a change at this time. We note the rejection of the implementation date, may reflect a concern of this type by industry.

We are currently minded to reject this modification for the reasons outlined above. The GB electricity system has gone through significant changes since the work leading to the parties' recommendation on this modification and we want to make sure we understand all the evidence in its present context.

Next steps

Therefore, given these concerns, we are seeking industry views on the attached documentation and our current minded to reject position. While we value your views on anything related to this proposal, we are particularly interested in your responses to the following questions. We ask that you consider these as part of any submission to this consultation:

- Do you agree with our minded to decision to reject DCP137, for the reasons set out above?
- What in your opinion are the impacts of this change on existing and new distribution connected generation for instance, the impact of this change on competition, cost-reflective charges and generator behaviour?
- What are the benefits and/or costs of the proposed change for generators, DNOs, IDNOs and any other affected parties (please specify)?
- For DNOs, have you identified any generation dominated areas on your networks? Have you had to, or are you planning to, undertake reinforcement work that is driven predominantly by generation?
- Can you provide further evidence in support of, or against, this change proposal?

We have included the Change Declaration and relevant documentation provided to us by the working group as supplementary documents on our website.

Please indicate clearly if you consider your response to be confidential, including a reason for this.

The consultation is open until 9 January 2015. Responses can be submitted to DistributionPolicy.ChargingMailbox@ofgem.gov.uk .

Yours sincerely

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